

# AMICUS CURIÆ

Journal of the Society for  
ADVANCED LEGAL STUDIES

ISSUE 112  
Winter 2017

## IN THIS ISSUE

### **FUTURE OF THE COMMERCIAL CONTRACT IN SCHOLARSHIP AND LAW REFORM 2018**

Contributions from the Third  
Annual Conference at the IALS .....2

### **COMBATING THE LAUNDERING OF PROCEEDS OF CRIME**

An analysis of the Criminal  
Finances Act 2017 .....25



**GENERAL EDITOR**

**Professor Barry A K Rider**, *Professorial Fellow, Development Studies Programme, University of Cambridge, Fellow Commoner and sometime Fellow, Dean and Tutor of Jesus College, Cambridge, Honorary Senior Research Fellow, IALS*

**DEPUTY GENERAL EDITOR**

**Julian Harris**, *Associate Research Fellow, Institute of Advanced Legal Studies*

**ADVISORY COUNCIL OF THE INSTITUTE OF ADVANCED LEGAL STUDIES**

Chair: **The Rt Hon Lord Carnwath**

**Sir Geoffrey Bowman**, *KCB, QC*

**Professor David Caron**, *King's College, London*

**Professor Hugh Collins**, *Chair, Law Section, British Academy*

**Professor Fiona Cownie**, *University of Keele*

**Professor Hazel Genn**, *University College, London*

**Professor Rosa Greaves**, *University of Glasgow*

**Christopher Hale**, *Partner, Travers Smith*

**Professor Emily Jackson**, *London School of Economics and Political Science*

**Professor Roger Kain**, *Dean, School of Advanced Study, University of London*

**Paul Kohler**, *School of Oriental and African Studies*

**The Rt Hon Lord Justice Lloyd Jones**, *Chair, Law Commission*

**Ian Macleod**, *Legal Adviser to the Foreign and Commonwealth Office*

**Professor Linda Mulcahy**, *London School of Economics and Political Science*

**Professor Valsamis Mitsilegas**, *Queen Mary*

**Ahmet Mustafa**, *Student Representative*

**Professor Alan Paterson**, *University of Strathclyde*

**Professor David Sugarman**, *University of Lancaster*

**Professor Patricia Tuitt**, *Birkbeck College*

**Jules Winterton**, *Director and Librarian, IALS*

**ADVISORY COUNCIL OF THE SOCIETY FOR ADVANCED LEGAL STUDIES**

Chair: **Lord Scott of Foscote**

**Colin Bamford**, *Barrister, 3-4 South Square*

**Dr Evan Bell**, *Public Prosecutions Service for Northern Ireland*

**Michael Blair QC**, *3 Verulam Buildings*

**The Hon Mr Justice Cranston**

**Professor Rosa Greaves**, *University of Glasgow*

**Peter Harris**, *former Official Solicitor*

**The Rt Hon The Lord Hope of Craighead KT**, *former Deputy President, The Supreme Court of the United Kingdom*

**Sonya Leydecker**, *Herbert Smith Freehills*

**The Rt Hon The Lord Mackay of Clashfern KT**, *former Lord Chancellor*

**George Staple QC**

**Sir John Mummery**, *former Lord Justice of Appeal*

**Dame Heather Steel DBE**, *former High Court judge*

**Dr Edward Swan**, *Visiting Professor, UCL*

**Jules Winterton**, *Director and Librarian, IALS*

*Amicus Curiae* is published quarterly by the Society for Advanced Legal Studies and issued free of charge to SALS members. The journal is also available on subscription (£75 per annum for four issues including p&p to UK and Europe, £85 pa for the rest of the world).

For further details please contact SALS, Institute of Advanced Legal Studies, 17 Russell Square, London WC1B 5DR (tel: 020 7862 5865; email: SALS@sas.ac.uk), or access the SALS website (<http://ials.sas.ac.uk/SALS/society.htm>).

Contributions to *Amicus Curiae* are welcomed. Articles should be accompanied by the name and address of the author. The journal can accommodate short pieces of approximately 700-1,200 words, and also longer articles of up to 4,000 words. Articles should be written in an informal style without footnotes. *Amicus Curiae* carries articles on a wide variety of topics including human rights, commercial law, white collar crime, law reform generally, and topical legal issues both inside and outside the UK.

Articles should be sent to Julian Harris at the Institute of Advanced Legal Studies, 17 Russell Square, London WC1B 5DR (tel: 020 7862 5868; email: Julian.Harris@sas.ac.uk). The Editorial Board reserves the right to refer articles to external referees for consideration.

The Society for Advanced Legal Studies does not accept responsibility for the accuracy of contributed articles or statements appearing in this publication. The views expressed by the authors of contributed articles should not be regarded as the official view of SALS except where stated.

Typeset and printed by imageData Group, Exion 27, Crowhurst Road, Hollingbury, Brighton BN1 8AF

ISSN 1461-2097

© 2017 Society for Advanced Legal Studies

## CONFERENCE HIGHLIGHTS AT THE INSTITUTE

The IALS stages high-quality conferences covering a wide range of subjects, and this editorial focuses on two events which took place in 2018. The Third Annual Conference on “The future of the commercial contract in scholarship and law reform”, presented on 12 October 2018, reflected the findings of research undertaken during 2016-18 at the IALS Centre for Corporate and Finance Law (CFL). The CFL runs an ongoing research project on the subject, maintaining an international network of participating scholars, and the conference was organised in collaboration with the Universities of Westminster and Exeter. The event focused on the interface between public and private law, and the articles by five of those who gave presentations are featured in this issue and showcase the work of the CFL.

There could be no better time to publish “The consequences of Brexit on existing and future commercial law contracts”. Given the continuing uncertainty as to the shape of any future regulatory framework for cross-border commercial transactions with Europe and beyond, Muriel Renaudin, of Cardiff University, bases her discussion on the assumption that the UK will leave the European Union without continued membership of current EU trade and judicial cooperation agreements. In “The paradoxes of the theory of *imprévision* in the new French law of contract: a judicial deterrent?” Catherine Pédamon of Westminster Law School, University of Westminster, revisits the theory and practice of hardship in the context of Article 1195 CC of the rewritten Civil code that now enshrines the theory of *imprévision* (unforeseeability) in French law. “Commercial registers and transparency”, by Maren Heidemann of the IALS, highlights recent reforms of commercial registers in Europe, as well as challenges and opportunities arising from transparency registers and their relationship to the traditional commercial register. “The regulatory power of international trade contracts over 19th century Dutch commercial sales law” investigates how national courts accommodate the changing commercial practices out of which disputes arise; Janwillem Oosterhuis, of the Faculty of Law, Maastricht University, addresses this and other issues from a historical perspective. Finally, in her article “Harmonisation impossible? On the evolution of the English, French, and Bulgarian approach to hardship in commercial contracts”, Radosveta Vassileva of UCL considers the approaches to hardship adopted by different jurisdictions.

Mention must also be made of Sirajo Yakubu, who studied for his PhD at the IALS and has contributed “Combating the laundering of proceeds of crime in the United Kingdom: an analysis of the Criminal Finances Act 2017” to this issue.

The second event to be highlighted is “Transforming cities with AI: law policy and ethics”, the 2018 Annual Conference of the Information Law and Policy Centre (ILPC) held at the Institute on 23 November 2018. The writer of this editorial attended the conference and was asked by the organisers to give a closing address drawing together the various themes raised during the day. Artificial intelligence can be quite a daunting subject for those without much scientific or technical knowledge, but a technology revolution has taken place in recent years which has completely changed the landscape of communications and information law, as the conference illustrated.

## Articles

The consequences of Brexit on existing and future commercial contracts 2

The paradoxes of the theory of *imprévision* in the new French law of contract: a judicial deterrent? 10

Commercial registers and transparency 18

**Institute News 25**

## Articles (cont'd)

The regulatory power of international trade contracts over 19th century Dutch commercial sales law 27

Harmonisation impossible? On the evolution of the English, French and Bulgarian approach to hardship in commercial contracts 34

Combating the laundering of proceeds of crime in the United Kingdom: an analysis of the Criminal Finances Act 2017 43

Baroness Onora O’Neill, Emeritus Professor of Philosophy (University of Cambridge) and Cross Bench Member of the House of Lords, delivered the 2018 ILPC Annual Lecture entitled “Ethics for Communication”. Baroness O’Neill called for ethics for communication, rather than ethics of communication, because her chosen title moves beyond addressing the relationship between ethics and communication, or the extent to which communication is ethical, and instead names a decisive purpose for which communication must be directed.

The conference keynote panel included leading figures from government, industry, academia, and civil society, with Tony Porter (Surveillance Camera Commissioner), Helena U Vrabec (Legal and Privacy Officer, Palantir Technologies), Peter Wells (Head of Policy, Open Data Institute) and Baroness O’Neill. This panel was chaired by Dr Nóra Ni Loideain (Director, ILPC) with Silke Carlo (Chief Executive, Big Brother Watch) as discussant.

The conference divided into four panels, the first of which – AI and transport – focused on discussing the legal and implications of smart cars. The second panel – AI, decision-making and trust – examined the different governance mechanisms and policy narratives around public trust and oversight that have framed the development of AI-decision making systems to date. In “Automated due process? Criminal justice and AI”, the third panel addressed the use and governance of AI-driven systems within the criminal justice sector. The final panel – AI and autonomy in the city – brought together an interdisciplinary range of speakers to discuss the use of AI technologies both in cities and in legal administration. Selected articles appear in issue 24.1 of the quarterly journal *Communications Law*, published by Bloomsbury Professional, sponsors of the conference with the John Coffin Memorial Trust.

## Julian Harris

*Deputy General Editor, Amicus Curiae*

*Sadly the time has come for me to move on, and I have ended my involvement with the IALS and Amicus Curiae after some 21 years spent in various roles. I would like to thank my colleagues, the many contributors to the journal and everyone else associated with the publication for their support during my period of tenure.*

# The consequences of Brexit on existing and future commercial contracts

by Muriel Renaudin

---

## 1. INTRODUCTION

On 29 March 2017, the British Prime Minister, Mrs Theresa May served formal notice under Article 50 of The Lisbon Treaty (Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community [2007] OJ C306/01) to terminate the United Kingdom's (UK) membership of the European Union (EU) following the June 2016 referendum. Pursuing Article 50, the EU Treaties will cease to apply to the UK and the UK exit will take effect on 29 March 2019. The withdrawal of the UK from the EU is commonly encapsulated in the term Brexit. What Brexit means for the law governing transnational commercial contracts depends on the model legal framework which will be adopted between the EU and the UK. At the time of writing, the shape of this new legal framework is still unknown and it is possible that the negotiation of new trade agreements with the EU could take several years beyond 2019. Until an agreement is reached as to the shape of this new regulatory framework for cross-border commercial transactions with Europe and beyond, commercial actors may be confronted with legal uncertainties vis-à-vis performance and enforcement of their existing and future commercial contractual agreements. Given the level of uncertainty as to the shape of this new legal framework, the following discussion will be based on the assumption that the UK will be leaving the EU without continued membership of current EU trade and judicial cooperation agreements.

Measuring the impact of Brexit for commercial contracts is difficult to do with any precision given the current degree of uncertainty. On the one hand, one may argue that Brexit should not have any detrimental effects on English contract law because the law of contract is essentially governed by the principles of freedom of contract and sanctity of contracts; the parties are free to agree express terms and conditions to their contractual agreements and courts must enforce them (see Lord Toulson's observations in *Prime Sight Ltd v Lavarello* [2013] UKPC 22; [2014] AC 436, para 47). Given that English contract law, as a whole, has predominantly remained untouched by European legislation, some may argue that the exit of the UK from the EU should not have any significant

impact on contractual agreements governed by English law. European law has only attempted to harmonise specific aspects of contract law such as consumer contracts (see the EU Consumer law acquis which includes the Doorstep Selling Directive 85/577, the Package Travel Directive 90/314, the Unfair Contract Terms Directive 93/13, the Timeshare Directive, 2008/122/EC, the Distance Selling Directive 97/7, the Price Indication Directive 98/6, the Injunctions Directive 98/27 and the Consumer Sales Directive 99/44). A more comprehensive harmonisation of general principles of contract law at European level remains limited, principally through the enactment of soft law instruments such as the European Principles of contract law (2002) (on this point see S Vogenauer and S Weatherill, "The European Community's Competence to Pursue the Harmonisation of Contract Law—an Empirical Contribution to the Debate", in S Vogenauer and S Weatherill (eds), *The Harmonisation of European Contract Law* (Hart, 2006)). Although the withdrawal of the UK from the EU and from all current EU trade agreements may not significantly impact English contract law as such, the reality is that the bargains struck by parties in their commercial contractual agreements may become adversely impacted. Indeed, the economic gain from contractual relationships may be generated and facilitated by existing EU legislations. For example, in the absence of alternative trade agreements, cross border trading tariffs may become applicable to commercial contracts trading goods. Contractual parties may also need to apply for specific export/import licences in respect of particular categories of goods which may also lead to an increase in contractual costs (on this point see European Commission 'Notice to stakeholders - withdrawal of the United Kingdom and EU rules in the field of import/export licences for certain goods' issued on 25 January 2018). This article argues that a continued membership in current trade agreements will avoid the uncertainties created by Brexit and will ensure that principles of commercial law such as predictability, security and low costs are maintained. If contractual parties are required to incur additional costs in the performance of their existing contracts as a result of Brexit, this article further considers whether financial hardship may constitute a ground for termination under English contract law.

Cross border commercial contracts may also contain clauses on jurisdiction the validity and enforcement of which may become uncertain once the UK leaves the EU and once the UK terminates its membership of relevant EU treaties underpinning cross border litigation. This article argues that leaving the current EU legal framework governing the validity and enforcement of clauses on jurisdiction may leave a significant legal vacuum likely to affect the security of cross-border commercial contracts. Not only may this legal vacuum threaten the validity and enforceability of this type of clause, it may also diminish the popularity of English contract law and of London as the choice of jurisdiction to govern cross border commercial transactions.

This article is divided in three parts. The first part discusses and evaluates some of the legal consequences of Brexit on cross border commercial contracts in the event of the UK deciding not to maintain its membership of current EU trade agreements. It considers in particular the impact of Brexit on the economic viability of commercial contracts and discusses whether parties could invoke Brexit as a ground for contractual termination under English contract law. The second part addresses the impact of Brexit on the validity and enforceability of choice of jurisdiction clauses for commercial contracts. It will be argued in the light of the various possible outcomes that, from a legal perspective, continued membership to current EU trade agreements and judicial cooperation agreements will maintain predictability, security and efficiency in the performance and enforcement of transnational commercial contracts. The final part of this article supports the argument that such continued membership would also ensure the maintenance of the long-standing position of English contract law and London as the preferred forum and jurisdiction for cross border transactions.

## 2. THE IMPACT OF BREXIT ON THE ECONOMIC VIABILITY OF COMMERCIAL CONTRACTS

### 2.1 *The law of contract, fuel of commerce*

Although the function of contract law cannot be reduced to the sole purpose of promoting economic development, because it also aims to fulfil a wider range of interests (M Renaudin, “The modernisation of French secured credit law: law as a competitive tool in global markets” *International Company and Commercial Law Review* 24 (11) 385-92), it is undeniable that contract is intrinsically linked to the economy (see eg K W Dam, *The Law-Growth Nexus: The Rule of Law and Economic Development* (Brookings Institution Press, Washington DC, 2013)). The modern capitalism system would not be possible without the law of contract. In *An Economic Analysis of Law*, Richard A Posner explains that contract law performs a fundamental economic function. First, it enables individuals and fictional entities such as companies to exchange goods and services efficiently. Second, it provides an efficient legal framework that enables

parties to engage in commercial transactions securely and at low costs. Finally, the law of contracts informs the parties of potential pitfalls that have arisen in the past, thus enabling the parties to carefully plan for the future and agree terms and conditions to ensure more predictable outcomes. Commercial actors thus expect the law of contract to promote commercial transactions by ensuring legal predictability, security and low costs in the performance and enforcement of contracts. In light of this initial postulate, businesses in the UK are thus legitimately concerned about the effect of Brexit on their existing and future contracts with the rest of Europe and beyond. The exit of the UK from the European Union may introduce hazards and uncertainties in relation to cross border commercial relationships which may impede the achievement of these paramount goals of commercial and contract law (see eg M A Crowley, O Exton and L Han “Renegotiation of Trade Agreements and Firm Exporting Decisions: Evidence from the Impact of Brexit on UK Exports” (2018) Cambridge-INET Working Paper Series No: 2018/10 Cambridge Working Papers in Economics, 1839).

### 2.2 *Freedom of contract and the bargain struck by the parties*

One may argue that the impact of Brexit on commercial contracts is likely to be neutral as to whether the UK leaves or remains in the EU. This is because contractual agreements are governed by the principle of freedom of contract and sanctity of contracts. Contracts are thus less regulated than many other areas of law and are based on the commercial bargain agreed between the parties. On the other hand, one may argue that the commercial bargain of the contract may become affected by Brexit. For example, agreements that currently rely on existing European legislation, particularly all legislation deriving from the operation of the single market such as that guaranteeing free movements of goods and services, may become less cost-effective. For example, cross-border contracts may become more costly to perform due to the introduction of import tariffs between the EU and non-EU states if no trade agreements are reached within the negotiation process (see discussion below). Cross-border contracts may become more costly if there are delays at ports because no agreement is reached with the EU. The World Bank’s Doing Business database reports that the typical time to clear border checks in high-income countries can reach twelve hours and forty minutes. Restrictions on the freedom of movement of people could lead to labour shortages or increase the costs of labour, or both. Brexit may also trigger fluctuation in currency, it is possible that a depreciation of the pound sterling will make some contracts less cost-effective. There could be further changes in exchange rates, such as those that immediately followed the result of the referendum in June 2016 when the pound sterling fell sharply against the dollar and the euro. Changes in the law that relates to intellectual property rights, for example licences may also pose problems (Government’s Guidance, “Exhaustion of Intellectual Property

Rights if there's no Brexit Deal", published 24 September 2018). Insolvency and relocation of businesses as a result of Brexit may also lead to difficulties and uncertainties (see eg A Kokkinis, "The Impact of Brexit on the Legal Framework for Cross-Border Corporate Activity" (2016) 27(7) *European Business Law Review*, 959–87). As a result of the uncertainties triggered by Brexit, businesses will need to consider their exposure to risks and additional costs in existing contracts and consider how these risks could be allocated in future contracts. The following discussion provides a more detailed account of the possible impact of Brexit in the event of a "no deal" scenario for commercial contracts that currently rely on the EU single market trade agreements, particularly focusing on the uncertainties linked to the imposition of new tariffs.

### 2.3 *Uncertainties and financial hardship for commercial contracts that currently rely on EU single market trade agreements*

The EU single market provides a legal framework that guarantees the free movement of goods, services, capital and labour. The European Commission defines the European Single Market as follows:

*The single market refers to the EU as one territory without any internal borders or other regulatory obstacles to the free movement of goods and services. A functioning Single Market stimulates competition and trade, improves efficiency, raises quality, and helps cut prices. The European single market is one of the EU's greatest achievements. It has fuelled economic growth and made the everyday life of European businesses and consumers easier.*

Businesses in the UK, EU and partner countries are eligible for a range of preferential market access opportunities under the terms of the Single market legal framework. EU trade agreements may for example include preferential duties for goods or provide a reduction in import tariff rates across a variety of goods. On Brexit day, all current EU trade agreements will cease to apply to the UK. A complete withdrawal from these trade agreements may significantly impact businesses when preferential conditions cease to apply. In 2016, the Office for National Statistics reported that EU accounted for 48 per cent of goods exported from the UK, while goods imported from the EU were worth more than imports from the rest of the world combined. UK imports in 2016 from the EU were £318 billion in comparison with £243.0 billion with the rest of the world. UK exports in 2016 were £235.8 billion to Europe and £284.1 billion from the rest of the world. The government has expressed the willingness to agree bilateral UK-third country agreements from the date the UK will leave the EU. If such bilateral treaties are not agreed, then the default rules provided by the World Trade Organisation (WTO) on tariffs and quotas will become applicable. At the time of writing, the UK's membership is currently contained within the EU schedules of concessions. The UK will thus need to regularise its WTO membership and set up its own independent

schedules of concessions before current EU trade agreements cease to apply. These independent schedules of concessions will contain new applicable tariffs and quotas on goods (Art II of the WTO General Agreement on Tariffs and Trade (GATT)) and new market access commitments for services (Art XVI of the General Agreement on Tariffs in Services (GATS)). Once the UK's independent schedules are set, they will require the approval of all WTO members including the EU. The latter requirement may raise some uncertainty for traders in the situation where other WTO members disagree with the new UK schedules of concessions. In order to avoid the risk of rejection, the UK might replicate the concessions already in place under the EU's schedules or may decide, more riskily, to unilaterally concede a free trade agreement. Even if the UK obtains the approval of its own schedules of concession as an independent WTO member, cross-border traders may still face significant uncertainties and additional costs.

In the absence of trade deal with the EU on Brexit day and assuming that WTO rules do apply, trade would take place on a "most-favoured nation" (MFN) basis (Art I GATT and Art II GATS). Under WTO rules, the principle of MFN treatment means that the same rate of duty, on the same goods, must be charged to all WTO members equally. Therefore the same tariff will apply, no matter if a product is imported from Australia or France. This situation may have a detrimental economic impact on businesses. For example, certain industries, such as the motor trade industry in the UK, may become significantly impacted as a result of a "no deal" Brexit. This type of industry usually relies on a complex integrated EU supply chain. In the motor trade industry, it is common that the various stages of the manufacturing process are conducted by different plants based in different EU Member States. Under WTO rules, new tariffs could be imposed at each of the various stages of the manufacturing process leading to substantial additional costs for businesses. Such a scenario could deter businesses from implanting themselves in the UK and could also encourage existing businesses to relocate somewhere else in Europe. These eventualities could be detrimental to the UK's economy and lead to substantial job losses (In November 2018, Schaeffler and Michelin, announced plans to close UK factories ahead of Brexit putting 1,400 jobs at risk). The UK Government may decide to offer subsidies to help threatened industries in the short term but this solution is clearly not sustainable and not permitted for certain industries (eg agriculture). Whether other WTO members agree to such derogations for the UK as an independent trade partner also remains unclear.

In light of the above uncertainties and risks of additional costs for cross border traders and businesses in the absence of a trade deal with the EU on Brexit day, it is argued that continued membership of current EU trade agreements would avoid financial adversarial risk for commercial actors and would also avoid the loss of predictability and certainty in cross border commercial agreements. If the economic viability of commercial contracts become negatively impacted

as a result of a ‘no deal’ Brexit, such as where tariffs become due, commercial actors may enquire into the possibility of terminating their contract.

## 2.4 Financial hardship caused by Brexit: available remedies

From an English law perspective, commercial actors may enquire into the possibility of Brexit providing grounds for termination of contract where the bargain struck by the parties is no longer cost-effective. Commercial parties may seek to rely on the doctrine of frustration or rely on force majeure clauses or material adverse change (MAC) clauses as grounds for termination. The success of such grounds for termination will obviously depend on upon the factual circumstances of the case and how the courts interpret the particular clause.

### 2.4.1 Frustration

Under English contract law, the debtor cannot in principle escape from his liability to perform the contract, no matter the reason. This is a strict liability, clearly recognised in *Nicolene Ltd v Simmonds* [1952] 2 Lloyd’s Rep. 419 at para 425 where Sellers J explained that:

*It does not matter whether the failure to fulfil the contract by the seller is because he is indifferent or wilfully negligent or just unfortunate. It does not matter what the reason is. What matters is the fact of performance. Has he performed or not?*

Nevertheless, English contract law is prepared to recognise in certain situations that the debtor should be excused from performance where the contract has become impossible to perform “because the circumstances in which performance is called for would render it a thing radically different from that which undertaken by the contract” (Lord Radcliffe in *Davis Contractors Ltd v Fareham Urban District Council* [1956] AC 696 at 729. See also E McKendrick, *Force Majeure and Frustration of Contract* (Informa Law from Routledge, 2013), ch 2). Frustration effectively means that the contract has become impossible to perform because one essential element of the contract has been destroyed (*Taylor v Caldwell* [1863] 3 B&S 826). Frustration has also been accepted when performance is possible but has become pointless (*Krell v Henry* [1903] 2 KB 740). When a contract is frustrated, the debtor is relieved from his obligation to perform the contract. To provide relief from liability for non-performance of contractual obligations does to a certain extent undermine and contravene the principles of security and predictability of agreements and also places the risk of non-performance on the promisee. It is thus not surprising that English judges have been quite reluctant to frustrate contractual agreements on the basis of this doctrine (see eg *British Movietonews Ltd v London and District Cinema* [1952] AC 166; *Tsakiroglou & Co Ltd v Noble Thorl GmbH* [1962] AC 93; *The Nema* [1982] AC 724 and *J Lauritzen AS v Wijsmuller BV (The Super Servant Two)* [1990]

1 Lloyd’s Rep 1). The scope of frustration being so narrow, it is arguable that a change in the contractual economic bargain struck by the parties as a result of Brexit will not excuse the debtor from performing the contract. Although, the contract may become more costly or more difficult to perform for the parties, the promisor will not be excused from performance simply because the economic bargain of the contract is adversely impacted as a result of Brexit. Unless the promisor can demonstrate that performance of the contract has become impossible because one element of the contract has been destroyed, the promisor will not be able to escape liability for non-performance. Accordingly, if the contractual parties want to expressly agree the allocation of risks, contractual parties may wish to include a force majeure or material adverse change clause into their contract to cover unexpected financial hardship caused by Brexit.

### 2.4.2 Force majeure clause

Force majeure clauses, though an unfamiliar concept for the common law, is a well-established French law doctrine which excuses the promisor from performance under certain circumstances (on this point see E McKendrick, *Force Majeure and Frustration of Contract*, (Informa Law from Routledge, 2013), ch 2). French law defines force majeure in the Civil code at Article 1218 as an irresistible and unforeseeable event. There is no definition per se of force majeure in English law but contractual parties will often insert such clauses to escape liability for non-performance under certain circumstances. Donaldson J explained in *Thomas Borthwick (Glasgow) Ltd v Faure Fairclough Ltd* [1968] 1 Lloyd’s Rep 16, at p 28, that: “The precise meaning of the term, if it has one, has eluded lawyers for years.”

McEndrick further explains that:

*An event will be force majeure event if it constitutes a legal or physical restraint on the performance of the contract (whether or not occurring through human intervention, although it must not be caused by the act, negligence, omission or default of the contracting party) which is both unforeseen and irresistible (E McKendrick, Force Majeure and Frustration of Contract (Informa Law from Routledge, 2013), p 5).*

Could contractual parties be able to rely on a force majeure clause in the event of Brexit to escape liability for non-performance? English courts have generally held that changes in a party’s economic circumstances will not qualify as force majeure events under English law (See *Tandrin Aviation Holdings Ltd v Aero Toy Store LLC and another* [2010] EWHC 40 (Comm)). The fact that economic hardship will be suffered is not normally sufficient to claim relief from performance. The interpretation of the clause by English courts will depend on the exact wording of the applicable clause and it is possible that some types of clauses, for example, material adverse change clauses, could be wider than a standard force majeure clause and could potentially be triggered by financial hardship

suffered as a result Brexit.

### 2.4.3 Material adverse change clause

Material adverse change clauses (MAC) enable the parties to renegotiate the terms of their contracts or to terminate the contractual agreement upon the occurrence of certain events. The party seeking to terminate the contract has the burden of proof to demonstrate that the particular material adverse event has occurred. The changes in circumstances following the supervening event must also be material, that is sufficiently substantial and significant to trigger a change in material circumstances. It cannot be a temporary glitch. The question of whether the changes in circumstances caused by Brexit will be caught by a MAC clause will depend upon the drafting of the clause itself. For future contracts, a MAC clause can be especially drafted to capture the situation where Brexit materially changes the circumstances of the contract but for an existing contract, the outcome will depend upon the interpretation of the clause by the courts (on this point see e.g. H Tse, *Doing Business After Brexit: A Practical Guide to the Legal Changes*, (Bloomsbury Professional, 2017).

## 3 THE CONSEQUENCES OF BREXIT FOR THE DISPUTE RESOLUTION SYSTEM AND ENFORCEMENT OF CROSS BORDER COMMERCIAL CONTRACTS

Regulation (EU) 1215/2012 of the European Parliament and of the Council on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast) (Brussels I Recast), currently governs the enforceability of jurisdiction clauses and judgments between EU Member States. The Brussels I Recast enables civil courts in any EU member state the power to give a judgment which can immediately be enforced in the jurisdiction of any other member state, without the intervention of the relevant court of that member state. With regards to the legal framework that governs choice of law clauses, the provisions contained under the Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) and the Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II) are currently applicable. Similarly, the above legal framework recognises the validity and enforcement of choice of law clauses within EU Member States. Other EU Regulations may also apply to cross-border transactions such as the cross-border service of documents and taking of evidence (Service Reg 1393/2007 and Evidence Reg 1206/2001). There are also further specialised Regulations that may apply to cross border transactions such as Regulations on jurisdiction, recognition and enforcement in the area of cross-border divorces and matters of parental responsibility (Brussels II bis Reg 2201/2003); on maintenance (Reg 4/2009) and on cross-border insolvencies

(Reg 1346/2000, replaced by Reg 2015/848 (recast)).

As an EU Member State, the UK is also party to international conventions in the area of civil and commercial law matters such as the 2005 Hague Convention on Choice of Court Agreement (The Hague Convention) and the 2007 Lugano Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Law Matters (Lugano Convention) which encapsulate to a certain extent a similar legal framework as the Brussels I (Recast). The EU, Norway, Iceland and Switzerland are also parties to the latter Convention. For the purpose of this analysis, the following discussion will focus on the validity and enforcement of jurisdiction clauses following a “no deal” Brexit.

The legal framework contained under the Brussels I Recast allows a judgment given by an English court to be enforceable in any other EU Member States without the need for exequatur. The system thus ensures predictability and certainty for commercial actors. Commercial actors can enforce their judgments in the jurisdiction of any other EU Member States. The system is essentially based on mutual recognition. The UK clearly acknowledges the need for a cooperation system to remain in place upon the UK leaving the EU. The House of Lords in the UK published a report on cross-border civil and commercial disputes in March 2017 (UK House of Lords, European Committee “Brexit: Justice for families, individuals and businesses” 17th Report of session 2016-2017) which clearly states that departing from the current EU legal framework would create uncertainties for businesses and will also have a negative impact on London’s legal market. The European Commission echoed this finding and issued a notice to stakeholders, emphasising that the UK’s exit from the EU will create “considerable uncertainty” for businesses and that practitioners should expect significant “legal repercussions” following Brexit. More recently, the UK Government published a position paper in which it sets out its priorities for a future EU-UK cross-border litigation regime (UK Government, “Providing a cross-border civil judicial cooperation framework: a Future partnership Paper”). The position paper recognises the importance of cooperation in relation to cross border litigation. Paragraph 9 of the same paper states that:

*A close cooperative relationship between the legal systems of the UK and the EU is of mutual importance, and thousands of EU corporations have established a place of business in the UK. Companies across the EU choose to use English law to govern their affairs and it is the most popular contract law used for conducting international transactions. Research indicates that English law governs around 40 per cent of global commercial arbitrations.*

Given that London currently represents a global hub for international litigation, one can assume that the UK Government will wish to maintain that pre-eminence by retaining close links with the EU system. But while a number



of post-Brexit scenarios are possible, none offers the same degree of predictability and uniformity as the current system.

In the situation of a “no deal” scenario, Brussels I Recast will cease to apply to the UK upon the UK leaving the EU in March 2019. As explained above, the UK Government has already issued some guidance which suggests that there will be a level of co-operation between EU and UK courts, but at the time of writing this level of co-operation remains quite vague and uncertain. The government could decide to replicate the provisions contained in the Brussels I recast but the difficulty is that the Regulations depends heavily on mutual recognition between states to be imported unilaterally. As a result, the continuity of such rules to apply in the UK would require some form of international agreement treaty, either with the EU, or with Member States individually through bilateral agreements. Indeed, without a formal agreement, there would be no obligations on other EU Member States to enforce judgments rendered by UK courts. This situation may trigger substantial uncertainties for commercial parties. Alternatively, it may be possible for the UK to accede to the Hague and Lugano Conventions, but this would require the consent of all current signatory states, including all 27 EU Member States. The Hague Convention provides a similar legal framework to the Brussels I Recasts. Signatories to the Hague Convention recognise the validity of jurisdiction clauses selecting other Hague signatories, and also enforce judgments in any of the Hague jurisdictions (see guidance from the UK Ministry of Justice “Handling Civil Legal Cases that involve EU Countries if there is no Brexit deal”, 13 September 2018). However, the Hague Convention offers more grounds on which a party can object to the registration of their judgment for enforcement, so enforcement may be longer and more costly than under the current Brussels I Recast. There are also some fundamental differences between Brussels I Recast and the Hague Convention. The scope of application of the Hague Convention is more restricted than the Brussels I Recast. For example, tort claims and business to consumer relationships which currently fall within the scope of Brussels I Recast are excluded from the Hague Convention. Accession to the Lugano convention may also be problematic because the UK would need to become a signatory as an independent state. There are restrictive accession criteria. If the UK decides to become a signatory of the Lugano Convention, it would also need to “pay due account” to the Court of Justice of European Union (CJEU) rulings on the interpretation of the Convention. The Lugano convention also differs in some extent from the Brussels I Recast in still requiring exequatur proceedings.

Certainly, EU Member States and the UK have a continuing interest in ensuring their own judgments are enforceable in the UK and in other EU jurisdictions. One would expect that the EU and the UK are likely to co-operate even if the UK does not accede to the Hague Convention and/or Lugano Convention as an independent Member State. However, given that the Brexit date is fast approaching and in the absence

of a confirmed individual membership to these alternative legal frameworks, parties to international contracts may seek alternative contractual dispute resolution options to avoid the risk of uncertainty caused by Brexit. Although more expensive, commercial parties may want to rely on arbitration as a possible alternative dispute resolution system. Arbitration should not be affected by Brexit because both Brussels I Recast and the Hague Convention exclude it from their scope. A recent report from Thomson and Reuters surveyed one hundred chief financial officers across the UK and Europe which revealed that only 10 per cent of surveyed businesses have swapped jurisdiction clauses for arbitration clauses, but of those, half indicated that uncertainty over Brexit was a quite significant or very significant factor in their choice. However, the report also emphasises that despite arbitration being considered as a potentially Brexit-proof option, arbitration may not be appropriate for all cross-border disputes (Thomson Reuters report, “35% of businesses choosing EU courts over UK due to Brexit uncertainty”, 23 July 2018).

## 4 THE CONSEQUENCES OF BREXIT ON LONDON AS THE MAJOR HUB FOR RESOLVING CROSS BORDER DISPUTES

### 4.1 *The attractiveness of English courts in resolving cross-border commercial disputes*

London boasts about being the preferred forum for resolving disputes. There are many reasons for this. First, commercial parties generally elect English law courts to resolve their commercial contractual disputes because English courts will ensure that their agreements are upheld. Indeed, English courts adopt a non-interventionist approach regarding commercial contracts. Judges adopt an objective approach in assuming equality of bargaining power between commercial parties. For example, in *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2011] UKSC 38, [2012] 1 AC 383 at [103], Lord Collins explains that: “[d]espite statutory inroads, party autonomy is at the heart of English commercial law.”

In *Cavendish Square Holding BV v El Makdessi* [2015] 3 WLR 1373 at [35], Lords Neuberger and Sumption stressed the need to protect party autonomy in commercial transactions as opposed to consumer transactions. This approach is justified by both the principles of freedom of contract and sanctity of contracts. Secondly, English courts have consistently favoured considerations of certainty and predictability over considerations of fairness and justice. For example, in *Vallejo v Wheeler* (1774) 1 Cowp 143 at [153], Lord Mansfield explains that:

*[i]n all mercantile transactions the great object should be certainty: and therefore, it is of more consequence that a rule be certain, than whether the rule is established one way or the other. Because speculators in trade then know what ground to go upon.*

In *Mardorf Peach & Co Ltd v Attica Sea Carriers Corp of Liberia, The Laconia* [1977] AC 850 at 878, Lord Salmon states that: “Certainty is of primary importance in all commercial transactions.”

Finally, Lord Bingham in *The Golden Victory* [2007] UKHL 12, [2007] 2 WLR 691 at [1], states that: “[T]he [majority’s] decision undermines the quality of certainty which is a traditional strength and major selling point of English commercial law.”

English contract law is also said to be flexible. English courts generally recognise and take into account commercial customs and usages in interpreting commercial contracts (see eg P Devlin, “The Relation Between Commercial Law And Commercial Practice” (1951) 14 MLR 249, 251). Commercial customs and usages must be reasonable, consistent with the express terms of the contractual agreement and must be universally recognised in the trade as a binding custom.

In the event of a “no deal” Brexit, one may enquire whether commercial parties may be deterred by the uncertainties introduced by Brexit and whether they might decide to depart from English courts as their choice of jurisdiction. From the UK’s perspective, it is arguable that the position of London as the major hub for resolving commercial disputes will remain unchanged after Brexit, whatever the outcome. Courts will arguably continue to provide speedy, inexpensive and efficient judgement. Courts will also continue to protect parties’ autonomy, certainty and predictability. On the other hand, in the context of cross-border transactions, the recent survey by Thomson Reuters looked into the impact of Brexit on dispute resolution clauses. It found that 35 per cent of respondents said that the uncertainty around Brexit had changed their approach to dispute resolution clauses. The report provides that:

*Of the 65% who said that they or their clients had not already changed their approach, 39% intended to review the dispute resolution clauses in their or their clients’ international contracts if there is no significant progress in negotiation of the future jurisdiction and governing law regime that will apply after Brexit by March 2019. However, many respondents acknowledged compelling reasons why English jurisdiction may remain a positive choice even after Brexit—51% of those surveyed identified clarity, fairness and predictability of the substantive law to be a key factor in selecting a choice of jurisdiction, and certainly this is an area where English law still enjoys a clear lead over many EU jurisdictions (Thomson Reuters Report “35% of businesses choosing EU courts over UK due to Brexit uncertainty”, 23 July 2018)*

#### **4.2. Cross-border litigation and Brexit: new opportunities for continental courts?**

In the event of a “no deal” Brexit scenario, the decisions rendered by UK courts will no longer be automatically enforced in other EU Member States and will need to be exequaturally

enforced as already explained in the above discussion. Such procedure may appear burdensome for some international businesses and could introduce legal risks and uncertainties. The level of uncertainty surrounding the impact of Brexit on cross border litigation, may thus open up opportunities for other jurisdictions to become more legally attractive. The example of France may be one amongst others but will serve as illustration for the purpose of the argument.

The French Minister of Justice saw an opportunity in the prospect of Brexit and explored ways to make Paris “more attractive in the eyes of the world” as a major hub for resolving cross border litigation (Ministry of Justice press release, 12 February 2018 available at <http://www.justice.gouv.fr>). On 7 February 2018, a new international Chamber of Commerce was created within the Paris Court of Appeal with competence to deal with cross-border litigations. The creation of this new commercial court unquestionably follows the logic of modernisation and of rendering France and French law more attractive. France recently modernised its law of contract in an Ordinance dated 10 February 2016 to become more attractive and competitive. The Attorney General of Paris, Catherine Champrenault, commented that the London market of legal activities generated a turnover of 16 billion euros in 2016 making London the number one hub for legal and financial products and services (Le Monde du Droit, “Création d’une Chambre Internationale: Paris au centre de la résolution des litiges commerciaux”, press article 9 February 2018). The Financial Markets Association of Europe estimates that  $\square$ 1.3 billion of banking assets are based in the UK and are associated with the cross-border supply of financial services and products to various countries’ customers (Association for Financial Markets in Europe (AFME), “L’impact du Brexit sur les contrats de service financiers transfrontaliers”, paper published in September 2017). These services and products are supported by a considerable number of contracts that may require litigation in case of disputes.

The newly created Paris International Chamber of Commerce is competent for all disputes relating to international trade contracts subject to French law or that of another state. The use of English language will be permitted during the hearing and for exchange of documents relating to the proceedings. Nonetheless, if these documents are written in English, they will have to be accompanied by a translation into French. The use of English is not exclusive and another language may be chosen by the parties. The use of a foreign language before the French courts is not in principle prohibited. Article 23 of the Code of Civil Procedure provides that: “The judge is not obliged to use an interpreter when he knows the language in which the parties express their views.” Therefore, the parties, their lawyers and the magistrates will be able to express themselves in a foreign language since a simultaneous translation can be provided if required. While the debates can take place in a foreign language, the proceedings and decisions will have to be drafted in French. Indeed, Article 2 of the French Constitution

states that “the language of the Republic is French” and since the Villers-Cotterêts Ordinance of August 1539, the French language is the only language authorised for any documents relating to proceedings as well as for case reports rendered by French courts. As a result, the new international court will have to render its decisions in French but they may be, if required, accompanied by a translation into a foreign language.

In the wake of Brexit, the flexibility to accommodate the use of foreign languages and the use of foreign laws including the English common law of contract may attract some of the international litigation to this newly created international court. The argument is not to say that one legal system is better than the other. Civil and common law jurisdictions are examples of legal systems which provide different contract and commercial law rules. Practice shows that commercial operators will choose the law of the court that is hearing the case on the basis of the contract’s underpinning economic bargain. The choice made by contractual parties is based on

coherent and pragmatic criteria. Indeed, the law of a particular legal system may be better suited to govern the particular commercial transaction. According to this approach, the creation of this new court may be envisioned as an opportunity to promote continental law and more specifically French law, especially since it was recently modernised to better suit the needs of commerce. The creation of this new court may only demonstrate the ability of French judges to speak English or to know English law; only time will tell whether other jurisdictions such as France can demonstrate they have competent jurisdictions that can meet the expectations and requirements of international trade actors.

**Dr Muriel Renaudin**

*Lecturer in Law, School of Law and Politics, Cardiff University*

# The paradoxes of the theory of *imprévision* in the new French law of contract: a judicial deterrent?

by Catherine Pédamon

---

Much has already been written about *imprévision*, frustration and impracticability in commercial contracts (Pédamon & Chuah, *Hardship in Transnational Commercial Contracts*, (Paris Legal Publishers, 2013)). It is however necessary to revisit the theory and practice of hardship in light of the new legal provision (Art 1195 CC) of the rewritten Civil code (CC) that now enshrines the theory of *imprévision* (unforeseeability) in French law.

The *Ordonnance* no 2016-131 of 10 February 2016 has implemented a reform of the law of contracts, the general regime of obligations and the proof of obligations that had remained nearly untouched since the original iteration of the Civil code in 1804 (See Pédamon, *The New French Contract Law and its Impact on Commercial Law*, in Heidemann, M and Lee, J (eds) *The Future of the Commercial Contract in Scholarship and Law Reform: European and Comparative Perspectives*, (Springer, 2018)). It has introduced a new article – Article 1195 CC – that ushers in a radical change from the well-anchored rejection of the theory of *imprévision* set in case law that dates back to the 19th century. It grants the judge power to review the contract upon the request of one party. In the Parliamentary debates for the ratification of the *Ordonnance*, the Senate attempted to limit this judicial power by requiring both parties to ask for this. It considered the unilaterally triggered power contrary to legal certainty as it could generate more litigation. After debate, the senators did agree upon the unilateral formulation of the current article on the basis that the provision is only a default rule and that in the case where a party asks the judge to adjust the contract, the other party is likely to request its termination, termination that the judge is likely to uphold. The senators nevertheless excluded securities transactions and financial contracts from the article (see the report prepared by Houlié and Pillet for the *Commission mixte paritaire* – Report no 352 (2017-2018)). The *Ordonnance* was ratified by the Act no 2018-287 of 20 April 2018.

So what did motivate the introduction of a provision allowing judicial review of contracts? Was it policy or commercial considerations? Is the new Article 1195 CC only an evolution in the footsteps of other European domestic rules and transnational legal principles or a response to commercial needs? Does this erode the principle of *pacta sunt servanda* and herald a more radical judicial approach to unforeseeability?

History traces the theory of *imprévision* back to the 12th and

13th centuries in the Roman rule – *contractus qui habent tractum successivum et dependentiam de future rebus sic stantibus intelliguntur* – that set limits to contractual sanctity because of economic instability. Its implementation led to commercial uncertainty that reduced its popularity. With the rise of scientific positivism and the philosophy of Enlightenment cherishing the freedom of contract, the Napoleonic code did not incorporate any provisions on unforeseeability. Over time, the French courts continued to reject the theory of *imprévision* as they upheld the principle of *pacta sunt servanda* strictly.

This theory raises the questions whether an unforeseeable change of circumstances that renders the performance of the contracts commercially impracticable may be considered as an excuse to non-performance, and what remedies are available to the parties. It mainly applies to commercial contracts, particularly instalment contracts whose performance consists of performance of repeated actions over a period of time and long-term contracts. These commercial contracts are the focus of this paper. As businesses negotiate the terms of their contract, they are expected not only to consider the existing circumstances but also to anticipate the circumstances that might affect the performance in the longer term. The contract therefore becomes an exercise of foreseeability. This is consistent with the doctrinal theory of *imprévision* that focuses on the *unforeseeability* of the event itself rather than its economic effects.

The new Article 1195 CC reflects the influence of other European country responses to unforeseen circumstances, including the German *Wegfall der Geschäftsgrundlage* or the Italian *eccessiva onerosità sopravvenuta*, and international legal projects, such as the Principles of European Contract Law (PECL) and the Unidroit Principles of International Commercial Contracts (Unidroit Principles). The *Rapport au Président de la République* (Report to the President of the Republic relating to the *Ordonnance* no 2016-131 of 10 February 2016) in its explanatory notes on Article 1195 CC stresses the importance of the European context as part of the justification for the reform:

*France is one of the last European countries not to recognise the theory of imprévision as a moderating factor to the binding force of contract. Its enshrinement inspired by comparative law as well as European harmonisation projects makes it possible to combat major contractual imbalances arising during performance, in*

*accordance with the objective of contractual fairness sought by the Ordonnance.*

These notes explain the objective of the theory of *imprévision*, which is to balance the principle of *pacta sunt servanda*, promoting the security of transactions, and contractual fairness. More importantly, the reform has a utilitarian dimension, which aims to keep the contract alive where it still has an economic and perhaps social role to play (Mekki and Kloepfer Pelese, “Hardship and Modification (or Revision) of the Contract (2010)”, available at SSRN: <https://ssrn.com/abstract=1542511>).

The reform is also a response to concerns of small and medium sized businesses about the absence of default rules on hardship in the Civil Code, which is more problematic for a sector where contracts tend to be less complete. This contrasts with larger companies that carefully insert detailed hardship provisions, dealing with matters such as material adverse change or price adjustment mechanisms, in their more complete contracts.

In light of these considerations, the *Ordonnance* now enshrines the theory of *imprévision* with some specificities. Article 1195 CC is concerned with adjusting the rights of two *innocent* parties – on the one hand, the right of the affected party that must continue to perform but needs a way out from a situation of commercial impracticability, and on the other hand, the right of the other party entitled to the performance of the contract. As the parties are better placed to understand their respective position in the transaction and make decisions, the preferred mode of resolution envisaged in the first paragraph of 1195 CC is renegotiation. When this fails, the next port of call – and ultimate one – is the court. The novelty of the article lies in the power of the court to adjust the terms of the contract or bring it to an end. The court now appears to have a greater degree of discretion to review the contract. This raises the usual questions about the conditions under which this can be exercised and the resulting effects.

As this paper shows, Article 1195 CC raises three paradoxes:

- *the first one in the nature of the article itself as a default rule that encourages a voluntary ex-ante contractual solution over a judicial solution through careful pre-emptive drafting;*
- *The second at the renegotiation phase as the affected party has the right to request renegotiation whereas the other contracting party the right to refuse to renegotiate; and*
- *The third in the new judicial powers that play as a deterrent and favour an ex-post contractual solution through renegotiation.*

Overall, this article demonstrates a clear bias for a private contractual and negotiated solution (over a judicial one). Small and medium sized businesses are likely to avail themselves of the new framework to redefine their contractual relationship. By contrast, larger commercial enterprises are further incentivised to enhance their self-reliance by boosting forward-looking contractual and expert determination provisions dealing with changed circumstances. In the words of the rapporteur for the Senate, “(t)he hypothesis where the judge will be asked by a party to review the contract will remain theoretical” (Pillet, in

the report prepared by the *Commission mixte paritaire* –Report no 352 (2017-2018)). The fear of a snowball effect with the provision generating a more interventionist judicial attitude appears exaggerated.

To understand Article 1195 CC and the new power of the courts to review the contract, it is necessary to explore (1) the context and particularly the judicial approach to hardship in commercial contracts overtime until the recent *Ordonnance*, (2) the conditions for the exercise and effects of the new provision on *imprévision*, and (3) the perspectives this article opens up in the case of chain or group of contracts.

## A CALL FOR REFORM

Until the reform enshrined in the *Ordonnance*, commercial impracticability could not be invoked as an excuse for non-performance on the ground of the principle *pacta sunt servanda*. Despite the rigour of this constant rejection, courts nevertheless gradually ascertained the existence of an obligation to renegotiate on the basis of the principle of good faith. The conditions of application of this new obligation had remained however unclear as case law shows, thus calling for legislative clarification.

### *The consistent rejection of the theory of imprévision*

The judicial rejection of the theory of *imprévision* can be traced back to the seminal decision of *Canal de Craponne* (Civ. 6 Mach 1876, DP 1876. 1. 193). In that case, the *Cour de cassation* refused to increase the fees that landowners had to pay in exchange for the maintenance and operation of the canal that were set more than three centuries ago despite an increase by more than 400 per cent of the actual costs. It based its decision on the principle of *pacta sunt servanda* enshrined in the former Article 1134 CC that provided that *agreements lawfully formed have the force of law for those who have made them*. As a result, it firmly prohibited courts from considering time and circumstances to adjust the terms of the contract, however equitable their decisions might appear. In successive cases, the *Cour de cassation* systematically quashed any such consideration of equity by lower courts to increase the contract price in light of the changed circumstances. As such, it embraced a strict interpretation of the intangibility of contracts, even where the performance of the contract had become commercially impracticable. The rigour of the solution was aimed at reinforcing the legal certainty ascribed to the contracts. Only a few cases have actually come to the attention of the *Cour de Cassation*; clearly not enough for this court to give up the well-anchored rejection of the theory of *imprévision* and any judicial intervention in the contract. A few variants have however emerged over time.

### *A gradual emergence of a duty to renegotiate in good faith*

In a couple of cases in the 1990s (Com. 3 November 1992, Huard, n° 90-18.547, Bull. civ. IV, n° 338; Com. 24 November 1998, *Chevassus-Marche*, n° 96-18.357, Bull. civ. IV, n° 277), the *Cour de cassation* ascertained an obligation to renegotiate based on the principle of good faith in circumstances of commercial impracticability. In these cases, the court acknowledged that the party claiming hardship, ie the distributor or the commercial agent, had been deprived of the ability of charging competitive prices due to the changed circumstances

and their state of economic dependency. The continuing participation of the parties in the market was threatened by the intangibility of the seriously imbalanced contract and justified a renegotiation of the terms of the contract by the party benefitting from the circumstances. In another decision of 2007 (CA Nancy 26 September 2007, D. 2008.1120), the Court of Appeal of Nancy expanded the scope of application of the obligation to renegotiate in a supply contract on the legal basis of good faith performance. The introduction of a new legislation for the reduction of greenhouse gases had caused a significant disequilibrium in the contract against the economic interest of the supply company that justified such obligation. The generality of the obligation to renegotiate was however questioned since all the cases examined related to the distribution industry.

In the context of an international sales contract subject to the Vienna Convention on Contracts for the International Sale of Goods (CISG) (1980), the issue of hardship has come up too. Whereas it is well-established that Article 79 CISG provides an excuse for a failure to perform any obligations in case of impossibility, domestic courts have to decide if it also applies in case of commercial impracticability. The now well-known case *Scafom International BV v Lorraine Tubes SAS* (Belgian C. Cass, 19 June 2009, C.07.0289.N, available at <http://cisgw3.law.pace.edu/cases/090619b1.html>) confirmed the existence of an obligation to renegotiate in good faith; it also showed the confusion of the courts when faced with a dispute on hardship. This case related to a number of contracts of sale between a Dutch buyer and a French seller for the delivery of steel tubes in Belgium. Following the increase in the price of steel by 70 per cent, the seller tried to renegotiate a higher contract price but in vain as the buyer refused and requested delivery of the goods at the contract price. The lower Commercial Court of Tongeren highlighted the failure of the parties to insert a clause in their contract for price adjustment and confirmed in line with French case law that “in the absence of such provisions, it was for the buyer to bear the risk of non-performance without being able to benefit from the provisions of Article 79 CISG...” (Civ 30 June 2004, RTDC 2004.845, obs Delebecque). The Court of Appeal of Antwerp overturned the lower court’s decision and, applying French law, held that the buyer had an obligation to renegotiate the terms of the contracts. Finally, the Belgian *Cour de cassation* rejected the application of French law. That said, it reached the same conclusion as the Court of Appeal and confirmed the obligation of the buyer to renegotiate the contracts (in good faith) as the unforeseen price increase gave rise to a “serious disequilibrium (in the obligations of the parties) that rendered the subsequent performance of the contract in the same conditions particularly detrimental (to the seller).” It based its decision on the Unidroit Principles as the general principles of international trade law that can be used to fill the gaps in the CISG in a uniform manner. Paradoxically, it confirmed that Article 79 CISG could, in certain cases, cover cases of hardship as changed circumstances that were not reasonably foreseeable at the time of conclusion of the contract and were unequivocally of a nature to increase the burden of performance of the contract in a disproportionate manner could constitute an “impediment.”

### *A case of judicial confusion?*

A succession of cases thereafter showed the confusion of the

*Cour de cassation* in its quest for a legal doctrine that could ground the theory of *imprévision* and justify an obligation to renegotiate – either on the basis of “cause” (Com. 29 June 2010, no 09-67.369; Com 17 February 2015, no 12-29550), or more recently on the basis of a duty of loyalty between the franchisor and franchisee (Com. 15 March 2017, no 15-16.406), or even the principle of good faith, as already mentioned. In passing it should be noted that the concept of “cause” has been removed from the rewritten law of obligations. Nevertheless, against the emergence of a contractual and amicable solution, the *Cour de cassation* re-asserted that courts did not have the power to adjust the terms of the contract (Civ 3e, 18 March 2009, No 07-21.260).

Another case – *Dupire Invicta Industrie (D21) v Gabo* (Com. 17 February 2015, no 12-29.550, 13-18.956 and 13-20.230) – once again considered the excuse of hardship in international sales. It related to a contract of sale between a French seller and a Polish buyer for the delivery of heating units. The buyer was also the seller’s exclusive distributor in Poland and Slovakia. The sale contract was governed by Polish law and did not contain a hardship clause as commonly done in the trade for these specific goods. Following an increase in the market price of raw materials, the seller refused to deliver the goods at the contract price invoking a case of hardship. As a result, the buyer sought compensation for the actual loss and loss of profit, as well as the payment of a penalty for late delivery as provided for in the contract.

The Commercial Court of Sedan denied the seller’s contention that it was entitled to withhold performance, even in a case of hardship. The Court of Appeal of Reims (Reims, 4 September 2012, n° 11/02698) also refused to grant any relief to the seller as it had failed to produce evidence that the price increase it suffered satisfied the requirements of hardship and, that even if he had suffered losses, the Unidroit Principles did not authorise the affected party to suspend performance. It held that the CISG did not exclude hardship, and that the Unidroit Principles could be used to interpret and supplement the CISG. It added that the seller had not demonstrated that the buyer had violated the principle of good faith when it had failed to renegotiate the price or postponed meetings to discuss the situation.

In its decision of 17 February 2015 (Com. 17 February 2015, no 12-29550, 13-18956, and 13-20230), the *Cour de cassation* held that the Court of Appeal had failed to ascertain whether the price fluctuations exceeded normal variations in the relevant marketplace and changed the additional burden on the seller into an excusable hardship, thus depriving its decision of a legal basis under the former Articles 1131 CC (“An obligation without a cause or with a false cause or with an unlawful cause cannot have any effect”) and 1134 CC (“Agreements lawfully formed have the force of law for those who have made them. They may be revoked only by their mutual consent, or on grounds which legislation authorises”. (...)), and Article 6.2.1 of the Unidroit Principles (“Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship.”) Nevertheless, it upheld the appellate decision on this point as the seller failed to prove that the increase in the cost of performance of its contractual obligations, or the new situation

that profoundly altered the balance of the contract, constituted a case of hardship. It also implicitly adopted the conclusions of the Court of Appeal that hardship falls within the CISG and that the Unidroit Principles define the scope and consequences of hardship. On the *renvoi*, the Court of Appeal of Nancy (Nancy, 14 March 2018, no 15/01554) confirmed the decision of the Commercial Court of Sedan on hardship, and rejected all the claims made by the two parties. Even in international sales, these cases show the difficulty for the courts in determining hardship.

### Lessons to be drawn from these cases

These cases highlight a few interesting points. The first one is the confirmation from the *Scafom* and *D21* international sales cases that the *Cour de cassation* is of the opinion that the CISG covers hardship, and that the Unidroit Principles can be used to interpret and supplement the CISG, particularly in a case of hardship. With the introduction of the theory of *imprévision* into the law of contract, there is now a risk of discrepancy in the application of the rules relating to hardship in domestic and international sales contracts. Such discrepancy may however be mitigated if the new Article 1195 CC is read itself in light of the Unidroit Principles, something that needs to be kept in mind. In any case, a contractual term can always set aside Article 79 CISG as well as Article 1195 CC. The second point relates to the emergence of an obligation to renegotiate in changed circumstances. This obligation is the precursor to the new right to request renegotiation in Article 1195 CC. It is very much in the spirit of settling the dispute through conciliation. Paradoxically, there is no obligation that the renegotiation leads to a common solution, even pursuant to the principle of good faith. As acknowledged in *D21*, a failure to renegotiate the price or the postponement of meetings to discuss the situation does not amount to a breach of good faith. This is consistent with previous decisions (Com. 3 October 2006, D.2007, at 765-770) that in the absence of abusive behaviour, the party that refuses to modify the terms of the contract does not attract liability. The limits to renegotiation are clear - if and when renegotiation fails, the next port of call remains the court. This leads to the third point that shows the traditional consistency of the *Cour de cassation* that always refused to adjust the terms of the contract in a case of hardship on the ground of *pacta sunt servanda*.

In the wake of these cases, and a growing sense of confusion, a legislative framework was therefore expected. It is now done following the *Ordonnance* as the new Article 1195 CC enshrines the theory of *imprévision* in the Civil code.

## THE PARADOXES OF THE (NEW) THEORY OF IMPREVISION

Except in rare cases where statutes were enacted to address specific economic circumstances had the French legislator ever allowed judicial adjustment of contracts. Examples of these instances are the Act of 21 Jan 1918 (*Loi Failliot*) (supplemented by the Act of 9 May 1920) and the Act of 23 April 1949 that provided for the termination of commercial contracts concluded before the beginning of the two World Wars, and the circular no 90-72 of 18 October 1990 that admitted *imprévision* in the context of the Gulf War if one of the parties suffered a prejudice exceeding the reasonable expectations at the date of

conclusion of the contract. In a (radical) move, the *Chancellerie* has now granted (ultimate) powers of review to the courts in case of changed circumstances when parties have exhausted means of conciliation. It is one of the most striking novelties of the reform. It is however interesting to note that French law is already familiar with the well-established theory of *imprévision* in administrative law (*Compagnie générale d'éclairage de Bordeaux*, CE, 30 March 1916, Rec. 125). It also follows in the footsteps of the recent Article L 441-8 of the Commercial Code that requires that a "clause relating to the terms of renegotiation of the price" be inserted in contracts of sales of products whose "costs of production are significantly affected by the fluctuations of prices of agricultural commodities and food products" (see Pédamon, *The New French Contract Law and its Impact on Commercial Law*, in Heidemann and Lee (eds) *The Future of the Commercial Contract in Scholarship and Law Reform: European and Comparative Perspectives*, (Springer, 2018)).

Article 1195 CC is contained in sub-section 1 on the binding force (of contract) that is part of section 1 on the effects of contract between the parties, itself in Chapter IV on the Effects of Contract. Article 1195 CC deals with the effects of hardship, but is silent as to whether it is an exception to the binding force principle. Is the new provision an exception, or simply a "moderating factor", as claimed in the *Rapport au Président*? Regardless of which it is, the juxtaposition of the binding force principle with the unforeseeability paradoxically reinforces the primary rule. By contrast, the equivalent provision in the PECL and Unidroit Principles is written as an exception. More substantively, the aim of this article, as expressly stated in the *Rapport au Président de la République*, is to "play a preventive role: the risk of destruction or adjustment of the contract by the court should encourage the parties to negotiate." It could not be clearer – in its activism for a conciliatory solution, the legislative focus is on the *renegotiation* of the contractual terms by the parties. This is consistent with the spirit of the overall reform, which empowers the parties to *avoid litigation or settle the dispute without judicial interference*.

Article 1195 CC is furthermore a default rule that is commonly set aside in sophisticated and complex commercial contracts that provide for hardship terms or indexation clauses, thus leaving the applicability of this article mainly to smaller commercial contracts as well as standard and non-commercial contracts. A distinction must be drawn between voluntary or anticipated renegotiation and involuntary renegotiation (Pédamon & Chuah, *Hardship in Transnational Commercial Contracts*, (2013), p 86). A hardship term commonly provides for renegotiation if and when certain defined or undefined events occur. As it has been contractually negotiated, the renegotiation is voluntary. By contrast, where there is no such clause in the contract, the statutory right to call for a renegotiation leads to involuntary renegotiation. Only with the threat of judicial review will this type of renegotiation succeed. Article 1195 CC provides as follows:

*If a change of circumstances that was unforeseeable at the time of conclusion of the contract renders performance excessively onerous for a party who had not agreed to bear the risk of such a change, that party may ask the other contracting party to renegotiate the contract. This party must continue to perform her obligations during the renegotiation.*

*In the case of refusal or failure of renegotiation, the parties may agree to terminate the contract from the date and on the conditions which they determine, or ask the court, by a common agreement, to set about its adjustment. In the absence of agreement within a reasonable time, the court may, upon request of one party, adjust the contract or put an end to it, from a date and subject to such conditions as it shall determine.*

The conditions of application of this new article and its effects must be considered.

### ***A limited application due to stringent conditions***

Several conditions must be met before any effect can be produced – the first one relates to the unforeseeable change of circumstances at the time of conclusion of the contract; the second one implies that the risk of changed circumstances has not been allocated to the party who is affected by the change, that is for the most part the seller; and the third one relates to the financial excessive performance of the contract.

### ***An unforeseeable change of circumstances at the time of conclusion of the contract***

The broad formulation of Article 1195 CC covers all kinds of changed circumstances – from a legal event, such as the introduction of a new legislation to an economic or financial one relating to a market fluctuation or bankruptcy or an environmental disaster. It is assessed against a test of unforeseeability that relates to the occurrence of the event itself as well as its scale (Deshayes, Genicon, Laithier, *Réforme du droit des contrats, du régime général et de la preuve des obligations*, Commentary, LexisNexis, 2016, p 393). Although not explicitly stated, the test of unforeseeability is objective in the sense that it requires that the affected party proves that a reasonable party in the same circumstances would not have foreseen the changed circumstances. It is commonly read in accordance with Article 1218 CC that defines *force majeure* as “an event beyond the control of the debtor, which could not reasonably have been foreseen at the time of conclusion of the contract (and whose effects could not be avoided by appropriate measures...)” despite the (unfortunate) difference in formulation (see Chantepie & Latina, *Le nouveau droit des obligations*, (Dalloz, 2nd ed) no 524, p 474). This analysis is consistent with the approach already adopted by the *Cour de cassation* despite the absence of the adverb “reasonably” qualifying “unforeseeable” in Article 1195 CC. The reasonable unforeseeability of changed circumstance must be assessed at the time of conclusion of the contract. In *D21 v Gabo*, previously discussed, the *Cour de cassation* criticised the Court of Appeal as it did not consider if the increase in costs of raw materials amounted to *abnormal* fluctuations in the relevant market.

Given the absence of clear standards and the imprecision of the notion, the test of *unforeseeability* leaves a rather wide margin of appreciation to the court, particularly as the market and relevant commercial practices evolve and become complex. How will the courts decide whether the changed circumstances – ie a labour shortage or an increased cost of production due to Brexit - fall within the ordinary range of commercial probability?

### ***A risk of change that has not been allocated to the party who is affected by the change***

The allocation of risks must be assessed as at the time of conclusion of the contract; it requires that courts ascertain the contemporaneous intention of the parties pursuant to the principles of contractual interpretation. These risks may not necessarily be expressly allocated in the contract; they may follow implicitly from the nature of the contract itself or by implication from the absence of any contractual provision. In a case of 2004 (Civ. 30 June 2004, RTDC 2004.845), the *Cour de cassation* held that:

*as a professional who is familiar with the practices of international trade, it was for the buyer to provide contractual mechanisms of guarantee or revision of contract. (...) (I)n the absence of such provisions, it was for the buyer to bear the risk of non-performance without being able to benefit from the provisions of Article 79 CISG (...).*

If that party bears the risk, it has to support the losses due to the changed circumstances.

Underlying this condition is the assumption that the parties are in a better position to make decisions about the risks associated with their transactions. Professor Gillette in “Commercial Rationality and the Duty to Adjust Long-Term Contracts” (69 Minn L Rev 521, 524 (1985)) argues that even if parties cannot foretell the future accurately, they can anticipate the existence of uncertainty and rationally provide mechanisms to estimate and control the consequences. His view is that rational planners tend to eliminate those risks at a cost less than their perceived cost. The presumption of completeness can however be rebutted if evidence of incomplete contracting is established. Parties can be prevented from writing complete contracts if the cost of actually negotiating the contracting terms is high – higher than the perceived cost of the risk itself. The function of contract law is therefore to provide default terms that a majority of parties would have chosen, thus reducing the cost of contracting *ex ante*. To what extent is it the case with respect to Article 1195 CC? This must be answered when considering the effects of the new legal provision.

It should be noted that, as a compromise negotiated by the senators during the parliamentary debates for the ratification of the Ordonnance, a new provision – Article L 211-40-1 of the Monetary and Financial Code – was adopted that excludes from the scope of application of Article 1195 CC, the promises arising from securities transactions and financial contracts (Art L. 211-1 I-III of this (same) code). These contracts escape the new statutory provision because of their speculative nature.

### ***The excessive financial burden of performance***

The formulation of Article 1195 CC reproduces Article 6:111 of the PECL that requires an “excessively onerous” performance that may be the result of an increase or diminution in cost; it is a formulation centred on the economic value of the performance due. How excessive should the performance have become to be excused, in other words, how significant should the financial losses be? As there is no set test to assess the excessive financial burden, lower courts can exercise their discretion in their consideration of the relevant factors. Furthermore, these considerations are matters of fact that



escape any control from the Cour de cassation. The vagueness of the criteria is problematic as it may lead to unpredictable outcomes, but from the cases already discussed, courts have been inclined to avoid assessing the financial losses. Additional questions remain unanswered, such as whether the undue financial burden can cover the loss of profits. Such uncertainties are an incentive for the parties to find a contractual solution.

A formulation closer to Article 6.2.2 in the Unidroit Principles would have been preferable as it refers to a fundamental alteration of the *equilibrium* in the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished. It sets an objective test anchored in the contract itself as it consists of assessing the equilibrium as originally agreed upon in the contract compared with the disequilibrium caused by the unforeseen circumstances. As held by the Belgian *Cour de cassation* in the *Scafom* case, the unforeseen price increase had given rise to a "serious disequilibrium (in the obligations of the parties) that rendered the subsequent performance of the contract in the same conditions particularly detrimental (to the seller)." The disequilibrium raises the question as to what the effect of this should be contractually.

### **The effects of *imprévision* – the bias for a contractual solution**

The novelty of Article 1195 CC lies in the effects of the *imprévision* in terms of remedies available to the parties – either to find a common contractual solution further to (involuntary) renegotiation or to request by common agreement or unilaterally that the judge finds the appropriate remedy – by either adjusting the terms of the contract or avoiding the contract itself. Although the court may decide to keep the contract as is, it is quite unlikely since the excessive financial burden calls for a solution.

### **The right to request renegotiation**

Once the conditions of hardship are met, the first remedy now available is the right for the party to call for a renegotiation of the contract. Such request may be accepted or refused (as indicated in the following sentence of Article 1195 CC – ie in the case of rejection or failure of renegotiation). Was legal permission necessary to grant this right as Article 1195 CC only provides for the ability to request renegotiation? Paradoxically it even departs from previous case law that had asserted an obligation to renegotiate in good faith. Underlying this provision is the idea that parties are willing to overcome together a situation of hardship and work out a solution to save their contractual relationship and avoid economic waste. During the phase of renegotiation, performance of the contract must continue. Does it imply *a contrario* that the affected party is entitled to suspend performance when the renegotiation stops or the other party refuses to renegotiate? Courts are likely to consider this remedy in light of the circumstances and against good faith.

Even if good faith permeates the whole life of the contract (as stated in the new Art 1104 CC – ("Contracts must be negotiated, formed and performed in good faith" (...)), courts have however traditionally narrowly interpreted the obligation to renegotiate in good faith. There is no obligation to reach an

agreement so long as the parties do not act contrary to good faith. As seen in *D21*, a failure to renegotiate the price or the postponement of meeting to discuss the situation does not amount to bad faith. Article 2.1.15 of the Unidroit Principles defines negotiations in bad faith in case where a party enters into or continues negotiations when intending not to reach an agreement with the other party; bad faith may consist of actual misrepresentation or non-disclosure of facts that should have been disclosed. It goes beyond foot dragging or even walking away.

More surprisingly is indeed the ability of the party who benefits from the unforeseeable changed circumstances to refuse to renegotiate. Refusing (involuntary) renegotiation is a right and does not amount to a breach of good faith. It is another paradox of Article 1195 CC given that renegotiation is the option pushed by the legislator to avoid unnecessary economic waste, but it is also a more realistic understanding of the commercial reality. What is the point to force a party to attend renegotiations against its will? The refusal to renegotiate must however be understood against the other remedies now available to the affected party, particularly the ability of the party to request the judge to review the contract or put an end to it. As a result, the beneficiary of the changed circumstances would lose its ability to bargain, and, in the worst-case scenario, the benefit of the contract itself. There is potential for double disadvantage for the party benefitting from the changed circumstances: loss of the ability to demand performance on favourable terms and need to supply itself in an altered (more expensive) market. This party is arguably penalised for having planned and contracted its original bargain carefully. (This disadvantage is nonetheless mitigated by incentives within the provision which re-balance the rights of both parties. Article 1195 CC operates a double set of incentives. The incentive for the benefitting party to maintain as much of the economic advantage as possible and therefore to renegotiate against the threat of a judicial intervention. In parallel, the incentive for the suffering party to settle the matter quickly since it must continue to perform its obligations during the renegotiation and may only request a court to review the contract *in the absence of agreement within a reasonable time*. The obligation to continue to perform is aimed at defeating opportunistic tactics from the affected party. Paradoxically it could be used by the benefitting party to drag out the renegotiations, but this could amount to a breach of good faith pursuant to Article 1112 CC ("The beginning, continuation and breaking-off of pre-contractual negotiations are free. They must mandatorily meet the requirements of good faith") by analogy. Additionally, by failing or refusing to renegotiate the advantaged party may commit a breach that leaves it exposed to liability pursuant to Article 1112 CC. This article provides however that "(i)n case of fault during the negotiations, the reparation of the resulting loss may not compensate either the loss of benefits expected from the contract or the loss of the chance of obtaining these benefits."

Article 1195 CC implies that the affected party has approached the other party to renegotiate the contract, at least as a pre-condition to lodging a claim. In practice, in light of previous case law, this is what happens, and what should happen.

The next step to the phase of renegotiation that has failed or

been refused is the ability of the parties by common agreement to terminate the contract. This is a manifestation of *mutuus dissensus*, as already expressed in Article 1193 CC (“Contracts can only be modified or revoked by the parties’ mutual consent or on grounds which legislation authorises.”) Termination occurs in an amicable fashion (*résolution amiable*). The concept used in French to refer to this mode of termination (*résolution*) is surprising given that termination can be agreed upon without any breach of performance (Chantepeie & Latina, *Le nouveau droit des obligations*, (Dalloz, 2nd ed) no 529, p 480). How realistic is this option since the renegotiation has failed showing the unwillingness of parties to accommodate each other’s interests? It is even more unrealistic to expect that the parties jointly “ask the court to adjust the terms of the contract.”

### **Judicial review of the contract – the choice between adjustment and termination**

This judicial solution – the solution of last resort - is the one that gives rise to much controversy, as it legalises the judicial review of the contract in a case of changed circumstances. Any fear of excessive judicial interference in the contract is however ungrounded. The paradox that emerges here lies in the deterrent effect of the judicial option as parties are now encouraged to work out a contractual solution. As such, this article reinforces the binding effect of the free will of the parties.

Where the renegotiation fails or the other party refuses to re-negotiate, the parties may jointly request the judge to adjust the terms of the contract. How likely is this judicial voluntary adjustment in a commercial context? Given that it is so unlikely, the practical consequence of this option is for the parties to reach agreement between themselves at an earlier stage. More relevant, is the ability of one party – any party? – to request the judge to adjust the terms of the contract or terminate it in the absence of agreement within a *reasonable time*. This is the novelty so much expected, and *de facto* so limited.

The judicial power is very much framed as a recourse of last resort. The threat of judicial review plays as a deterrent for the party that has an interest in keeping the contract in force to find a renegotiated solution. Although it is phrased quite unclearly, the purpose of this provision is to request that the affected party engage first with the other party for a renegotiation before going to court. The other party may refuse and go to court instead, so what can the judge do?

The judge has a choice between adjusting the terms of the contract or bringing it to an end “from a date and subject to such conditions as it shall determine”. There is no hierarchy between these remedies. The choice depends on the claim of the party. Can the judge impose an adjustment of the terms if the party has lodged a claim for termination, or vice versa? (T Revet, *Le juge et la révision du contrat*, RDC 2016, n° 16). The civil procedure rules appear to prohibit this. The judge may in fact exercise greater discretion if the claim made by one party is contested by the other party since under this scenario the judge will have to make a decision for the parties. In such a case, the court may consider the parties’ intention as expressed in the terms of the contract, the circumstances at the time of conclusion of the contract, and, as suggested in Article 92 of

the *projet Terré*, the *legitimate expectations of the parties*, together with the usage and practice of the market. The distinction between adjustment and termination may not be so easy to draw in practice.

It is striking how difficult it might be for the court to adjust the terms of the contract. How can the parties’ mutual practices in long-term contracts be discerned as they evolve and develop over a period of time? Which are relevant? However, courts are already familiar with the practice of adjusting the terms of the contract in other circumstances defined by the legislator. For instance, pursuant to Article 1231-5 CC, the judge may, even at her/his initiative, adjust the terms of contractual performance by moderating or increasing a contractually agreed penalty if it is manifestly excessive or derisory, or, pursuant to Article 1343-5 CC, defer payment of sums that are due or allow payment in instalments. A straightforward way of adjusting the terms of the contract will be for the court to modify the price in light of the indexes or other formulae extracted from the relevant market. An expert or any other neutral third party may be involved in the process of determining the appropriate adjustment terms. Other types of adjustment – at least in theory – may be considered as the term “revision” is broad; it can consist of reviewing the terms of delivery, the quantity of the goods, or any other contractual terms. Termination is the other option available to the judge. To do so may defeat the objective pursued in Article 1195 CC that is to avoid economic waste by forcing the parties to renegotiate the terms of the contract. However, there might be circumstances where adjustment is impossible for economic or opportunistic reasons.

Overall, the solution will depend on the (economic) benefits for one party to save the relationship and renegotiate the terms of the contract, or even on their common decision to terminate the agreement. Parties in an ongoing long-term relationship – the usual situation here – have a strong incentive to work out disagreements amicably rather than see the relationship destroyed by litigation. Through this lens, the (new) power of judicial review is limited, another paradox of Article 1195 CC. As a default provision, it rather encourages the parties to include in their contracts *ex ante* price variation clauses defining the parameters and mechanism for adjusting prices in cases of sudden and unexpected market fluctuations. Even if this inevitably adds up to the cost of contracting – ie the front-end costs – it may also save the cost of litigation or arbitration – ie back end costs. In practice, long-term contracts and complex transactions commonly include highly detailed provisions relating to hardship. However, even in this case, the notions used and the dispute resolution mechanisms in place can be imprecise. In the context of changed circumstances, the contractual relationship tends to become adversarial as each party focuses on the short-term and its own partisan interests. The new article can create an incentive for the parties to refer the adjustment of their contract to a (neutral) third party well versed in their markets, or even private arbitrators.

The absence of such contractual provision can be held against the affected party, as seen in previous cases. As a point of attention, it must be noted that a waiver in a standard form contract that would be non-negotiable and determined in advance by one party and would cause a significant imbalance in the rights and obligations of the parties, may be deemed not written pursuant to Article 1171 CC. Careful drafting is

therefore required.

## NEW PERSPECTIVES – THE EFFECTS OF IMPREVISION ON OTHER CONTRACTS

Another aspect of this new provision that must be considered is how the theory of *imprévision* will have a knock-on effect for other contracts in a vertical chain or transactional group. It raises an issue of allocation of risks. Whereas the facts are quite similar in the case of a chain or group of contracts, their legal consequences are different. In both cases, the economic consequences can be significant. Special care will be needed to ensure consistent application of Article 1195 CC across the group or chain of contracts. There may also be timing issues if Article 1195 CC is invoked sequentially.

### *Imprévision in a group or chain of contracts – Article 1195 CC*

As already discussed, Article 1195 CC implicitly requires that the affected party request a renegotiation before approaching the court. In theory, however, the party who benefits from the changed circumstances has no obligation to renegotiate, but in practice its conduct will be assessed against standards of good faith (See Com. 15 March 2017, no 15-16.406 for the liability of a franchisor who refused to renegotiate). It is likely that courts will be more robust with parties to groups or chains of contracts by forcing them to renegotiate because of the higher economic stakes. Although Article 1195 CC does not force the benefiting party to come to the table, the principle of good faith can be deployed by the court to bring pressure to bear on reluctant negotiators. If, as provided for in Article 1195 CC, the court is asked to intervene, it is likely that it will consider the economic operation as a whole and also the interdependence between the contracts, to understand the effects of *imprévision* and the remedies available. It may decide to adjust or terminate the contract. Termination can have serious economic consequences on the other contracts. One can imagine the courts exercising their powers of review with even greater caution in these scenarios? (Fauvarque-Cosson, “Does Review on the Ground of *Imprévision* Breach the Principle of the Binding Force of Contracts”, in Cartwright and Whittaker (eds) *The Code Napoléon Rewritten*, (Hart, 2018), p 201).

### *Imprévision in a group of contracts – Article 1186 & 1187 CC*

Article 1186 CC adopts a unique solution for groups of contracts. It provides for the lapse (*caducité*) of contracts whose performance is rendered impossible by the disappearance of one of them. It is consistent with the first paragraph of Article 1186 CC that states: “(a) contract which has been validly formed lapses if one of its essential elements disappears.”

This article enshrines the legal notion of group of contracts (*ensemble contractuel*), a concept previously developed by case law. What matters in the definition is to establish the link of indivisibility (*lien d’indivisibilité*) between the contracts.

This link can be an express term in the contracts or implied from the facts, particularly in light of the coherence of the contractual group that contributes to the same economic operation (Chantepie & Latina, *Le nouveau droit des obligations*, (Daloz, 2nd ed) n° 495, p 441).

Although the effect of lapse is significant, it is justified since the performance of the other contract has become impossible. Lapse is however a remedy only if the party against whom it is held knew of the existence of the contractual group when it gave its consent.

Article 1187 CC furthermore provides that the lapse brings an end to the contract and may give rise to restitution as set out in Articles 1352 to 1352-9 CC. In that sense, it differs from the appreciation of hardship as the disappearance of an essential element automatically causes its lapse that the judge (or the parties) must uphold. Restitution triggers other considerations in its application by the courts that go beyond this paper.

## CONCLUSION

In the footsteps of other European models and harmonisation projects, the theory of *imprévision* is now enshrined in the French Civil Code. The novelty of Article 1195 CC lies in the new judicial power of review. Some lawyers may fear a snowball effect of judicial intervention in commercial affairs. This paper should appease this anxiety as it is expected that French courts will exercise restraint when wielding their new power. Certainly, large businesses need not fear judicial discretion since they already have the know-how, which allows them to self-solve unforeseeability in detailed and sophisticated clauses. For smaller businesses, the framework for renegotiation, and when all else fails, the helping hand of experienced judges may be welcome.

The paradoxical attributes of Article 1195 CCC – the default rule, the dynamics of renegotiation and the judicial power of review – all operate to encourage parties to resolve disputes arising out of changed circumstances themselves. The strength of Article 1195 CC lies in its deterrent effect to avoid judicial interference and favour commercial solutions. The parties remain in control and the pact, albeit modified, is affirmed, thus reinforcing the principle of binding force of contracts. It highlights the importance of “the flexibility rather than the rigidity of the contract, its durability and its survival” in the face of unforeseeability as legal certainty requires some contractual flexibility (Pédamon & Chuah, *Hardship in Transnational Commercial Contracts*, (Paris Legal Publishers, 2013), p 37). This is consistent with a utilitarian and more pragmatic vision of the contract that concentrates on its economic value and the need for variation under the threat of contractual failure due to unforeseeable events that render the performance commercially impracticable (Mazeaud, *La révision du contrat*, Rapport Français aux journées Capitant, les Petites Affiches, 30 January 2005, n° 6).

### Catherine Pédamon

Senior Lecturer and Deputy Head for the LLM in International Commercial Law at Westminster Law School, University of Westminster

# Commercial registers and transparency

by Maren Heidemann

## INTRODUCTION

Commercial registers are a traditional source of information and a service for merchants. They have recently been subject to reform and modernisation and have been joined by additional registers and databases in the pursuit of transparency. This article highlights recent reforms of commercial registers in Europe as well as challenges and opportunities arising from transparency registers and their relationship to the traditional commercial register.

## A. COMPARATIVE REGISTER LAW IN EUROPE – MAIN FEATURES AND DIFFERENCES

There are two major types of commercial registers in Europe. Unsurprisingly they can be grouped along the lines of the traditional split between “civil” (or “continental” law) and common law jurisdictions. More technically, the continental register and notary systems follow a self-confessed “Latin” (Roman law) origin while the English system does not. As typical representatives of each type, the German and the English commercial registers can be examined here to set out the major features and differences between these two.

### A.1 German commercial register

Commercial registers in Germany are hosted by the local courts of first instance (*Amtsgerichte*). The law governing the registers is mainly found in the Commercial Code (*Handelsgesetzbuch*, HGB). The traditional *Handelsregister* has been joined by the *Unternehmensregister* (“enterprise register”, a database of company information in the context of financial transactions) in 2006 in response to the European Union’s reform of companies registers and to improve transparency by way of Directives 2003/58/EC and 2004/109/EC. The implementing federal legislative act in Germany was the *Gesetz über elektronische Handelsregister und Genossenschaftsregister sowie das Unternehmensregister* (EHUG). Sections 8-9b HGB stipulate that both continue to be operated by the local courts. It is obvious that this generally establishes a significant level of fragmentation regarding the information on any corporate entity. Accessing information about any merchant or corporation used to require knowledge of the location of the relevant register court. Even

though this would be part of the required information to be published by any merchant and displayed on stationery and official documents, there may be situations where an interested party does not have this information to hand. In a second step, the interested party would then have to contact the relevant register court and request information. This information comprises the name of the company (the firm, *firma*) details of the legal form and nature of a corporate entity, its constituting documents such as the shareholder agreement, its shareholders and their shares, its agents and representatives and in some cases its accounts and annual reports. This information is verified on the part of the merchant by notarisation and formal filing with the registrar. It is not verified as such by the register court. Companies and merchants can be held to account for the facts published in the commercial register. The published information constitutes a non-rebuttable presumption of correctness so that third parties can legally rely on it. This is called the publicity effect (*Publizitätswirkung*) of the register. This legally binding declaratory effect is derived from the form and procedure vouching for the initial scrutiny of the content being filed.

### A.2 English commercial register

By contrast, the English commercial register is hosted centrally by Companies House, a designated agency which hosts and operates the commercial register and acts as registrar. The registrar and the information required to be kept on file are governed by the Companies Act 2006, Part 34. The best-publicised difference to the continental register system is that the information on file is “not verified by Companies House” (when the difference is much rather that it is not notarised), but instead protected by rules contained in the Companies Act. Filing incorrect information constitutes an offence under the Companies Act (pursuant to Pt 35 of the Act, especially s 1112) and can lead to a company being struck off the register, its directors to be disqualified and even fined (see E below). The actual information to be filed is very similar to that contained in continental registers. However, UK companies are required to report annually on their shareholders and officers as well as on their accounts instead of merely publishing changes as and when they occur, as English company law differs from continental incorporation laws.

### A.3 Commonalities, pros and cons

Both register systems share the aim of a declaratory effect of the information filed and published. Both registers also exclusively confer constituting effects for instance in relation to limited liability, fungibility of shares or merchant status. The purpose of the selection of the information to be published is to provide traders and merchants with basic knowledge of each other's business. This serves to provide a basis for decision-making when selecting business partners. Therefore, a degree of reliability has to be achieved and maintained. It is obvious that the English system places more trust into the self-regulatory forces of the merchant community than the continental system which has a more supervisory quality with a kind of guarantee function attributed to the local courts. The information to be published in the commercial registers needs to be authenticated by a notary public even after the reform of 2007 when the filing was taken over by the Federal Gazette (*Bundesanzeiger*) in order to simplify procedures both for the benefit of merchants and the justice system. The continental system is owed to historical development out of a highly fragmented political landscape that existed until deep into the twentieth century and a sense that trading was subject to licensing and privilege rather than an unconditional right and a natural occupation possibly even for the state itself. High aspirations as to the quality of the information are often paired with restrictions to access in this system, for example in land registries. The English system by contrast, fosters accessibility encouraging free flow of information in this sector, treating it as a commodity rather than a privilege.

## B. REFORMS AT EU LEVEL: IMPROVING ACCESSIBILITY

A look around the world shows the variety of ways of organising commercial registers and of attitudes to accessibility, including the provision of technical facilities such as online access. The internet platform 'wikipedia' offers a list of commercial registers around the world including an indication whether they are publicly accessible or searchable online ([https://en.wikipedia.org/wiki/List\\_of\\_company\\_registers](https://en.wikipedia.org/wiki/List_of_company_registers)). The UK Government also provides a list of and links to foreign registries (<https://www.gov.uk/government/publications/overseas-registries/overseas-registries>). The criterion of accessibility is the main anchor for a raft of modernisation and recent reform in the area of registers and databases. Closely related to the rather neutral aspect of accessibility is that of "transparency". The latter term carries high aspirations across a range of applications and subject areas. It has been used in social and political debate and processes as well as in business related contexts defining monitoring and reporting standards and denoting access to information generally. It is certainly owed to this aspiration that the EU pushed for a modernisation and uniformisation of accessibility of commercial registers within the EU and the single market. Directive 2012/17/EU of the European Parliament and of the Council of 13 June 2012 – amending Council Directive 89/666/EEC and Directives

2005/56/EC and 2009/101/EC of the European Parliament and of the Council as regards the interconnection of central, commercial and companies registers – has been operational since July 2017. The result is a significant improvement of ease of access and online accessibility of commercial registers throughout Europe. What used to be standard in the UK in terms of online access is now introduced in regard of German registries, too.

In the UK, this may not be news, whereas in Germany, for the first time now, a company can be searched directly online from anywhere in the world. But is it really the same in terms of ease of use and scope of information?

The new German Register Portal (*Gemeinsames Registerportal der Länder*, joint register portal of the German states, English language version accessible at [https://www.Handelsregister.de/rp\\_web/welcome.do?language=en](https://www.Handelsregister.de/rp_web/welcome.do?language=en)) has an English language user interface to initially access information. A simple name search without the actual company number to hand may be a little onerous (A name search can return a huge list of companies with the same initials or in alphabetical order. Furthermore, identical numbers are often assigned to several companies, clubs and associations only distinguished by the place of affiliation, ie the place of the local court, and the letter indicating the relevant section of the register – partnerships, companies, associations, patents – such as A, B, V or P) but will lead the user to the local court where a company or trader is registered where the search can be refined. Some ("published") information is freely downloadable. Other information requires registration of the user and the payment of a small fee – much after the model of the UK Companies House. This is, however, where the difficulty arises for non-German speaking users: they are required to fill in the respective form to request such information in German. Whatever the limitations there, this initiative by the EU to create an EU wide standard for accessing company information online is truly splendid and provides a huge service to the international merchant community as well as to consumers.

## C. DIGITAL ACCESSIBILITY: BLESSING OR CURSE?

Information in digital form is certainly a blessing for users and providers of information services and operators of databases because they can catalogue, process, update, organise and distribute data timely and efficiently. It increases autonomy for users who become less dependent on the actual service provider and their opening times as well as postal and telecommunication services and it extends the geographical reach of the service provider as well as the data generally beyond its original jurisdiction into a virtually boundless space. This is certainly commensurate with the global trading space which has been growing through digital technology. At the same time, it can create an appetite for more data to be made accessible in this way. Besides the fact that data is also becoming a traded commodity as such – as commercial register content is being re-sold by third party providers – the idea of collecting

and publishing facts and information about not only relevant themes but about anything at all in the form of registers and databases gains more feasibility with the advent of digitisation and digitalisation. This has most likely supported the creation of further new registers at EU level or at the initiative of the EU. The term transparency has emerged in this context and applies to a range of different subject areas and policies. In view of the general possibilities that digital information offers it is therefore necessary to distinguish by the aims of each transparency initiative, its intended addressees and the content to be made accessible and to whom.

Closely related to this is of course the area of data protection and privacy as bastion of civil liberty or even a human right. Self-determination is probably one of the key criteria by which to measure the quality of data protection initiatives. Technical data safety has to be accompanied by a strong commitment to the protection of individual persons' and companies' right to "informational self-determination" (*informationelle Selbstbestimmung*) recognising the legal position of the data owner. Whether the EU has done enough in this respect with its latest General Data Protection Regulation (EU) 2016/679 (GDPR) is doubtful, given the strong interest in the generation of databases as described in this paper. This interest is shared by the state along with commercial enterprises and constitutes a pull factor into the opposite direction. Prioritising correctly within this conflict of interest is a central and indispensable task of the legislature and judicial organs (see further D.2 below).

#### D. TRANSPARENCY REGISTERS AND RELATED ONLINE DATABASES

One of the so-called transparency registers was established in the course of the European Transparency Initiative and aims to provide transparency in the area of political lobbying of the EU organs. The register is freely accessible and searchable by everyone and contains the details of organisations and individuals who aim at influencing law-making in the EU. Official lobbying meetings where stakeholders can explain their views and interests with EU policy makers can only take place with registered parties. This is to serve the public's interest to remain involved as much as possible in the selection of policies and legal instruments prior to the formal legislative process which is public. It also serves to counteract an impression of behind the scenes manipulation of the political process by powerful economic interests and therefore maintain the trust of the public in the integrity of the process of lawmaking and governing, or even reinforcing a sense of being in control. Critique of the new register has included the fact that registration was voluntary which has now been counteracted by a requirement that official lobbying meetings can only take place with registered persons or entities. Another point of criticism was the lack of control regarding the figures given by lobbyists about the budget which they allocate to their activities (on the evolution of the EU transparency register see Godowska, Magdalena, *Y B Polish Eur Stud* 2011 (14):181-

200; Milicevic, Aleksandra, 2017; the Mandatory Transparency Register Initiative – Towards a Better Governance of Lobbying in the EU, *Revija za evropsko pravo* 19 (1):71-113.). Whether this register really eliminated any "behind the scenes" activity must remain doubtful, therefore. It is certainly a welcome innovation and a step into the right direction.

##### D.1 Transparency in relation to private corporate entities

Using the same term, transparency, a new type of register has arrived on the scene in recent years in relation to the registration of information relating to private corporate entities. Germany has introduced the so called "transparency register" in respect of those entities which are not already obliged to register with the commercial register, *Handelsregister*. This new database is called the *Transparenzregister*. It has been made operational and searchable as of July 2017 and can be consulted by visiting the website <https://www.Transparenzregister.de>. This register is not searchable by everyone but only by certain specified persons and entities for specified reasons upon formal registration of their own details with the registry (according to s 23 of the German federal money laundering act (*Gesetz über das Aufspüren von Gewinnen aus schweren Straftaten (Geldwäschegesetz - GwG)*) and the regulation *Transparenzregistereinsichtnahmeverordnung* of 19 Dezember 2017, *Official Bulletin (BGBl)* I p 3984). It can be said that it effectively functions as a residual or fall-back register in relation to the obligation to provide the relevant data. It may be understood to make up for the "deficiency" of the commercial register of not being mandatory and comprehensive in relation to all corporate entities. The register was prompted by the obligation of the Federal Republic of Germany to implement the so-called Fourth Money Laundering Directive (Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing) as well as the Directive regarding financial transactions (Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds). A similar register was introduced in the UK, of course relying on the identical EU Directives. In the UK, the respective data collection is called the "Persons with Significant Control" register (PSC register). This "register" has to be kept and publicised by each company according to Part 21A (section 790M) of and Schedules 1A and 1B to the Companies Act 2006 as well as the Small Business Enterprise and Employment Act 2015, Part 7 and Schedule 3 (See also <https://www.gov.uk/government/news/people-with-significant-control-companies-house-register-goes-live>). Number 64 of the Explanatory Notes to the 2015 Act reads:

*At the G8 summit in Lough Erne in June 2013 the UK, alongside the rest of the G8 [n: now G7], committed to a number of measures to enhance corporate transparency in order to tackle the misuse of companies. The Government published a discussion paper on these proposals in July 2013, and published the Government response to the views received on the discussion paper in April 2014. The measures included in Part 7 of the Act (linked to measures in Parts 8 and 9) are intended to deliver*

these commitments. These include the commitment to introduce a register of individuals who exercise significant control over a company; the removal and prohibition of the use of bearer shares; the prohibition of corporate directors, except in certain circumstances and measures to deter opaque arrangements involving directors and make individual controlling directors more accountable.

The PSC register consists of additional information to be filed with the regular Companies House returns. Other than the German counterpart, it is not a separate register, and the information is accessible (for a fee) to all who search the Companies House records.

#### D.2. Transparency in relation to taxation – country-by-country reporting

Another recent arrival on the scene of registers and databases professing to enhance transparency is the so-called country-by-country reporting devised by the Organisation for Economic Cooperation and Development (OECD) through their so-called Base Erosion and Profit Shifting (BEPS) Action Plan, Action 13 (Published as OECD 2015, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report OECD/G20 Base Erosion and Profit Shifting Project (Paris, OECD)*). The OECD introduce their report with reference to transparency efforts:

*The Base Erosion and Profit Shifting (BEPS) Action Plan adopted by the OECD and G20 countries in 2013 recognised that enhancing transparency for tax administrations by providing them with adequate information to assess high-level transfer pricing and other BEPS-related risks is a crucial aspect for tackling the BEPS problem (see <http://www.oecd.org/tax/beps/country-by-country-reporting.htm>).*

This database will collate information regarding the amount of tax paid by multinational enterprises, so-called MNE groups, in each of their countries of operation by way of a report to be filed by MNE groups to the national tax authorities who are then entitled to exchange this information according to the recently entered into force Multilateral Convention on Administrative Assistance in Tax Matters as well as Tax Information Exchange Agreements (TIEAs) and so-called Model Competent Authority Agreements (MCCAs). Based on this legal framework, the OECD reports:

*As of September 2018, there are over 1800 bilateral exchange relationships activated with respect to jurisdictions committed to exchanging CbC reports, and the first automatic exchanges of CbC reports took place in June 2018. These include exchanges between the 72 signatories to the CbC Multilateral Competent Authority Agreement, between EU Member States under EU Council Directive 2016/881/EU and between signatories to bilateral competent authority agreements for exchanges under Double Tax Conventions or Tax Information Exchange Agreements, including over 35 bilateral agreements with the United States. Jurisdictions continue to negotiate arrangements for the exchange of CbC reports and the OECD will publish*

*regular updates, to provide clarity for MNE Groups and tax administrations*

These requirements far exceed previous entitlements of the tax authorities. As for Germany, the courts had strictly rejected this type of “fishing expedition” in earlier case law. In the case decided in 2016 by the tax court in Cologne (*Finanzgericht Köln*), 2 V 1375/15, the tax authorities of the E6 group exchanged information to create a “case profile” about the W group, their corporate structure and business model in order to derive information about similar cases and how to adapt laws and practices accordingly. BEPS was said to be the basis for this. The court barred the German fiscal authority from sharing this profile because there was no concrete reason for this and hence no legal basis, it was a fishing expedition. In a case decided by the FG Baden-Württemberg (Tax Court Baden-Wuerttemberg) on 25 June 2015 (3 K 2419/14) a German tax authority sought to gather information from a German company about its Italian business partners on behalf of the Italian tax authority (*Guardia di Finanza*). The court barred this enquiry due to the lack of relevance of the requested information for the taxation of the German company as well as due to the availability of the requested information in the public domain. The enquiry by the tax office was based on the EU Directives 2011/16/EU and 2014/107/EU (Revised Directive on Administrative Cooperation, DAC). On successful revision, the Federal Tax Court, *Bundesfinanzhof*, reversed the decision (judgment of 12 September 2017, I R 97/15) and reverted to the state tax court for reconsideration, albeit purely on procedural grounds rather than deciding on the merits of the case. (The case has not be re-decided yet.) The new laws emanating from international platforms like the OECD may be understood to provide enabling norms for the very action barred by the courts earlier. As I have explained elsewhere (Heidemann, Maren, 2017, “Is Internationalisation Going Too Far? – Constitutional Challenges of International Data Exchange Programmes”, EBLR 28 (5):847-78), there is little or no constitutional evaluation of the legitimacy of this recent campaign to order comprehensive reporting duties on the part of enterprises which enable general fishing expeditions by tax authorities. The aim of these enquiries is to gather information to be able to discern ‘patterns’ which might indicate unlawful behaviour (eg incorrect transfer pricing) as a prompt for official investigations. This has been criticised as inviting error and unfounded suspicion (Borges, Alexandre Siciliano, and Caio Augusto Takano, 2017, “The Improper Use of Country-by-Country Reports: Some Concerns on the Brazilian Approach to BEPS Action 13”, *Intertax* 45 (12):841-51; Grotherr, Siegfried, 2017, *Automatischer Informationsaustausch im Steuerrecht ueber laenderbezogene Berichte von Konzernunternehmen–Rechtsgrundlagen, Inhalt, Datenschutz und Probleme beim CbC-Reporting*, RIW 63 (1-2):1-17).

#### E. EVALUATION

The legal initiatives and registers described above provide a whole cluster of sources of information. Does the accumulation of these sources equal an increase in transparency, though? And

what ends would this transparency serve? Are the intended aims achieved by the traditional and more recent registers and reporting duties mentioned above?

There are two distinctions to be made in an evaluation of the new facilities: whose transparency do they serve; and what are the legal consequences of non-compliance?

First, the mission of traditional commercial registers is to enable traders to make *prima facie* judgments about their potential business partners and monitor existing business partners. They collate and publish selected key information which indicates basic facts about the commercial standing of the business partner, such as companies and partnerships as well as their individual officers. It indicates the size of the business, its success or failure, its compliance standard, whether it is in administration or a director is suspended. While this information is not exhaustive and cannot replace further research and an individual risk assessment for any business partners or investors, it is primarily directed towards the merchant community and the markets. It wants to ensure a minimum standard of transparency and integrity in the marketplace. To achieve this, the information has to be accurate and up to date. Annual reporting and enforcement rules serve this aim.

In line with this, the mission behind the digitisation of commercial registers, or company registers as they may be referred to, is aimed at improving access to this relevant information to merchants across a larger geographical area by creating registers which reach in fact across borders, so in a way these registers are now transnational without adding to the administrative burden for companies.

By contrast, the mission behind creating transparency registers seems somewhat different. Beneficiaries of the EU transparency register of lobbyists can be said to be the general public or the integrity of a political process in general. The mission can be described as signalling to the EU public that efforts are made to disclose the economic interests being “peddled” at EU decision-making bodies and to enforce certain guidelines and red tape in order to prevent undue influence on any holders of public office. Due to the weaknesses that remain in this system as sketched above this mission may not be accomplished just yet.

A mission of similar nature can be discerned in the further registers and databases created under the heading of transparency register registering ‘beneficial ownership’ and ‘CbC’ reporting. The public interest that seems to be served here consists of a rather suggestive understanding of crime prevention. It also serves the day to day business of the national tax authorities in helping to compile a global mosaic of information provided by multi-national enterprises which combined may reveal patterns which may indicate illegal behaviour. It is submitted here that the latter type of database lacks relevancy and exceeds any justifiable public interest. The former ‘register’ of beneficial ownership conflates legal and factual relationships of individuals with their businesses

and corporate entities and may therefore lead users without legal training to conclusions which are unjustified and legally wrong. The interest in some of this information seems to lack relevancy to the merchant community and remains of a purely anecdotal quality to the general public if disclosed.

Second, as described above, accuracy of the information published in commercial registers is monitored and enforced differently in different jurisdictions. Information may be actively verified by a notary or the official registry or accuracy may be protected by corresponding offences contained in the law. In the UK, Part 36 of the 2006 Act contains a list of offences, breach of which can lead to convictions including imprisonment and the payment of fines. The “first ever” case of such a conviction of a persistent offender was reported in March this year: businessman Kevin Brewer was fined £12,000 upon repeated fraudulent incorporation of companies and registering prominent figures of public life as directors and shareholders without their knowledge, thereby breaching section 1112 of the Companies Act 2006 (see <https://www.gov.uk/government/news/uks-first-ever-successful-prosecution-for-false-company-information>). The declaratory function of the information is also primarily utilised as evidence within private enforcement mechanisms, for instance by precluding a defence in civil proceedings against an innocent creditor who acts in reliance on the information published.

Similarly, the EU lobbyists’ transparency register has a conditional gateway function if and when lobbying is undertaken.

By contrast, in the case of the transparency registers and CbC reporting providing the information is mandatory and not directed at business partners or serving civil enforcement of private claims as described above. It is part of internal public administration and an end in itself.

## F. CONCLUSIONS

The traditional commercial registers have been joined over the past decade by a number of additional registers and databases to be populated by information about companies, merchants and private individuals. Adding to the traditional function of providing information and a level playing field in the market place, new functions are being performed by these. In addition to increasing the range of users of commercial registers by making them electronically accessible across the EU, electronic accessibility is used to provide transparency for a number of objectives. Transparency is not always that of the general public, investors or potential trading partners, though. Some of the new registers are register in name only; they are either databases collated by the authorities to whom the respective information is disclosed, or just additional content in regular reports or constituting documents. The EU lobbyists’ transparency register for instance could be called a freely searchable public database with information more of an informational nature rather than a legal basis for further action or decision making. The CbC reporting at the



other end of the spectrum by contrast could be said to form a register in the hands of the fiscal authorities who collate the information covertly by way of international data exchanges. It is not as such freely accessible by the public, in fact it remains hidden from the public, and therefore contributes little to transparency in this respect, but rather to the authorities' transparency only. Finally, the so-called transparency register listing "beneficial owners" of companies and other corporate entities in Germany is also not freely accessible and so cannot contribute to transparency as may be desired by the general public, but provides a rather elusive basis for consideration to those authorities who are entitled to refer to it. As regards the information collated, this is to a great extent already in the public domain. As far as it imposes duties and obligations on persons who were not previously required to be listed in this way, it may lack a constitutional basis for this duty. Scrutiny has not yet been exercised in regard of these registers. It is assumed that "transparency" is desirable and prevents crime, presupposing that there is crime on a level that justifies and necessitates the imposition of mandatory disclosure of this nature.

By way of example, one detail may illustrate the legal problem that the new "register" poses: in Germany charitable foundations are private non-commercial corporate entities. They do not have members and they have no beneficiaries in a strict legal sense. The volunteer directors of German charitable foundations are now required to be listed in the new German transparency register as "beneficial owners" (*wirtschaftlich Berechtigte*). This is not helpful at all for German charitable foundations who already suffer from the very weak infrastructure that German law provides for them. Not only are foundations creatures of state law rather than federal law, there is also no register for them as there is for commercial entities (which would be comparable to the UK register of charitable bodies). This makes it very hard for foundations to deal outside their state of incorporation (their seat) and specifically abroad where they lack a presentable means of identification such as a registration number. Foundations are listed by their regulatory bodies, but even if this is in electronic form, these lists are not proper registers but mere databases. The advent of the transparency register may be seen to help this situation. The classification of boards of directors of charitable foundations as beneficial owners, though, can be misleading – it can induce the erroneous belief that directors are members of the corporate entity or have any financial entitlements or interests in it. This is not the case under the German law of incorporation of private charitable foundations. The notion of "persons with significant control" is not used in the German terminology. It can therefore be said that the German transparency register creates false impressions rather than transparency. In the UK, the requirement for example to list shadow directors as "beneficial owners" or persons of significant control poses a similar problem in that relationships between individuals and businesses or corporate entities are created which have no precise legal description. Percentages in shareholdings are often used to describe the notion of significant control. It is, however, a well-known problem that

in the context of large scale professional asset management, persons (clients) are not always aware of their ownership at any given moment and so rather large grey areas are left by the legislation. It creates the illusion of simplicity where there is none. This is even more so in the description of a shadow director whose role may manifest gradually over a long period of time and the threshold for triggering the registration duty may be unclear especially for legally untrained persons who after all constitute the majority of the business community.

As for the value of the information logged, a word of caution may also be in order. Much of the information in the PSC or transparency registers will be in the public domain, so that bundling the information in a different format may lead to confusion rather than clarification as adding more layers of the same thing is not normally a recipe for simplification. This approach may create the impression of added disclosure and hence greater transparency. In order to understand and use the information properly the user needs some basic knowledge of the law or business practice. To users without such a minimum level of experience the registers may once again be misleading, especially because they were promoted as having been prompted by crime committed, for instance by the owners of so-called letter box companies. It has to be asked whether there is added value in relation to ordinary electronic freely searchable commercial registers or rather an increased compliance burden and significant defaulting risk for the obligated parties with the registers stating the obvious or lacking relevancy. On the one hand investors and potential business partners would certainly benefit from information for instance about shadow directors. Information about ultimate beneficial owners would save the user researching potentially across a multitude of registers globally some of which may not be freely and remotely searchable. This should be considered to be a service, though, rather than an act of crime prevention. Ownership and entitlement as such are no crime. The onus of detection investigation and legal evaluation of criminal activity remains with the public authorities. A certain preventive effect may be assumed. It is questionable though, whether the above described corresponding risk (reputational, compliance risks) has been scrutinised sufficiently prior to enacting the new mandatory and rather harsh legislation in terms of relevancy, effectiveness, proportionality, due process and other constitutional values. In case of the CbC reporting, the desired effect is only achieved by way of the international data exchange agreements as proposed and headed by the OECD.

The quality of the collated data described above resembles that of the transparency registers and PSC register in terms of availability in the public domain and indicator function for criminal or non-compliant behaviour. While the users of CbC reports may always be professionals in fiscal authorities around the world, this does not resolve the risk (involuntarily) undertaken by the owners of the data as to misuse and misunderstanding owed to the nature of electronic data as well as the discrepancy between where the likely damage is to arise and where the benefit is expected to materialise. The compliance risk on the part of the users, ie the tax authorities,

is particularly high due to an inherent conflict of interest caused by a discrepancy between infringement and damage: monitoring and enforcing compliance is in the interest of the data owners but not controlled by them whereas the same is not necessarily in the interest of those who actually control and enforce.

In conclusion it can therefore be said that the combination of instantaneous worldwide electronic accessibility and the widening of data to be provided to registers in connection with commercial acting poses as yet unresolved legal risks to the data owners and even to the integrity of the market place, for instance by lowering thresholds and pushing more participants into niches and even illegality. The boundaries between mere additional content, databases and registers are blurred by the use of ambitious terminology in this field and by responding to expectations which have been extensively promoted to the public by way of news reporting (“Panama papers”) and in some cases activism in the form of Parliamentary scrutiny committees (most prominently, Dame Margaret Hodge led the public enquiry as chair of the Commons Public Accounts Committee into the tax affairs on multinational enterprises, MNEs, which led to reputational losses and in some cases voluntary and random tax payments, see for instance

“Starbucks, Google and Amazon Grilled over Tax Avoidance,” BBC News website, 12 November 2012, Business) but which may much rather be prompted by long standing desires for more competences of the fiscal authorities to collate information which they were previously prevented from by the courts as well as by a vague expectation of an increase in tax revenue. There is a regrettable lack of judicial review in this area of legislative activity, in particular that originating from the OECD which lacks democratic oversight and a rule of law-based infrastructure comparable to that of the EU. So, despite a welcome innovative progress in this area of law, caution should be exercised in extending reporting duties and registration facilities without corresponding safeguards for the benefit of both users and data owners. Innovation should benefit the data owners as much as the users of the data and must take issues of privacy and due process into account.

**Dr Maren Heidemann**

*Assessor Iuris (Germany), PhD, LL.M (Nottingham), Associate Research Fellow and postgraduate supervisor, Institute of Advanced Legal Studies, School of Advanced Studies, University of London*

All events take place at the Institute of Advanced Legal Studies and are free unless a different venue or fee details are indicated. CPD accreditation is provided with many events. For enquiries and bookings please refer to Belinda Crothers, Academic Programmes Manager, IALS, 17 Russell Square, London WC1B 5DR (tel: 020 7862 5841; email: [belinda.crothers@sas.ac.uk](mailto:belinda.crothers@sas.ac.uk)). Advance booking is required for most events.

You can also find out what is coming up on the School of Advanced Study events listing page (<http://www.sas.ac.uk/support-research/public-events>) or on our Eventbrite (<http://www.eventbrite.co.uk/o/institute-of-advanced-legal-studies>) and Facebook pages (see <http://www.ials.sas.ac.uk/>).

**Wednesday 13 February 2019, 5.00 – 6.00pm**

## Seminar

*Women's Legal Landmarks – in conversation*

In the centenary year of women's formal admission to the legal profession, the IALS will host a series of talks exploring legal landmarks for women. All speakers were participants in the groundbreaking Women's Legal Landmarks Project led by Erika Rackley and Rosemary Auchmuty.

Sex Discrimination Act 1975

**ANNE MORRIS**

Sex Discrimination (Election Candidates) Act 2002

**SUE ATKINS**

Organised in collaboration with the University of Kent and the University of Reading.

*Women's Legal Landmarks: Celebrating the History of Women and Law in the UK and Ireland*, published by Hart Publishing, is out now.

**Friday 22 February 2019, 5.30 -7.00pm**

*"Their disputes determined by that more wholesome mode": arbitration in eighteenth-century England*

**DR FRANCIS BOORMAN**

IALS

Organised in collaboration with the London Legal History Seminar

**Thursday 28 February 2019, 10.00am – 4.30pm**

## How to get a PhD in law

*The PhD journey – supervision, research ethics and preparing yourself for upgrade and vivas*

The Institute of Advanced Legal Studies welcomes students

enrolled for an MPhil/PhD in law from across the UK to this specially tailored day of presentations, library tours and networking opportunities.

Sessions will be held on:

The PhD journey: The staging posts of your PhD and support for research students

**PROFESSOR EVA PILS**, Dickson Poon School of Law, King's College, London

A panel of research students who have completed or nearly completed their PhD's will discuss how they approached researching their theses and the PhD journey. Session to be open to questions from the audience and discussion

**DR CONSTANTIN STEFANOIU**, Director of the Sir William Dale Centre for Legislative Studies, IALS, will chair the session

Preparing for the ethics committee

**EMERITUS PROFESSOR AVROM SHERR**, IALS

Preparing for the upgrade viva and PhD viva

**DR NATASA MAVRONICOLA**, Senior Lecturer in Law, University of Birmingham

The foreign, international and comparative law research collections at IALS library

**HESTER SWIFT**, Foreign and International Law Librarian, IALS

Although tailored specifically for PhD in Law students, this training programme may contain some material which repeats and reinforces generic training suitable for all PhD students.

Fees and booking: Student: £75.00; Standard: £100.00 (staff and students of SAS should contact Belinda Crothers direct).

**Thursday 28 February, 5.00 - 6.45pm**

## Seminar

*Mind the Gap: a blueprint for a new regulatory framework that effectively captures citizen journalists*

In this seminar **PETER COE** argues that citizen journalism, facilitated by the internet and social media, is no longer an outlier of free speech, but is now a central component of the media, and public discourse. Therefore, the purpose of this seminar is not to discuss the merits of media regulation generally, or to tackle the issue of regulating the Internet and social media. Rather, it aims to address the issue of regulating citizen journalists. It starts from the position that despite the growing importance of citizen journalism from a constitutional perspective, the UK's current framework for media regulation does not provide an effective means of regulating citizen journalists and that, consequently, there is "gap" in the regime.

To fill this gap, Peter sets out a blueprint for a new voluntary, yet highly incentivised, regulatory system that draws on existing and proposed regulatory regimes from a number of jurisdictions.

Speakers:

**PETER COE**

ILPC Research Associate, Anthony Collins Solicitors LLP

**DR PAUL WRAGG**

Associate Professor of Law, University of Leeds Law School

**LAURA SCAIFE**

Associate solicitor, Addleshaw Goddard

**DR RICHARD DANBURY**

ILPC Associate Research Fellow, Associate Professor of Journalism, De Montfort University

Chair: **DR NORA NI LOIDEAIN**, Director of the Information Law and Policy Centre at the Institute of Advanced Legal Studies

This seminar will be followed by a wine reception.

**Thursday, 7 March**

**IALS PhD Masterclass**

*PhD Student Pastoral Session*

Guest panel session – an opportunity for PhD students to discuss how they are getting on with their PhD study and to seek/offer guidance on any particular concerns, such as work motivation and processes, research methodology, supervisor relationship, thesis writing, living accommodation or residence status.

**Wednesday 13 March, 5.00 - 6.00pm**

**Seminar**

*Women’s Legal Landmarks – in conversation*

In the centenary year of women’s formal admission to the legal profession, the IALS will host a series of talks exploring legal landmarks for women. All speakers were participants in the groundbreaking Women’s Legal Landmarks Project led by Erika Rackley and Rosemary Auchmuty.

First Women’s Refuge 1971

**FELICITY KAGANAS**

First Rape Crisis Centre 1976

**ALISON DIDUCK**

Organised in collaboration with the University of Kent and the University of Reading.

*Women’s Legal Landmarks: Celebrating the History of Women and Law in the UK and Ireland*, published by Hart Publishing, is out now.

**Friday 22 March, 5.30-7.00pm**

The origin of official law reporting in mandatory Palestine: a question of perspective?

**DR YAIR SAGY**

Haifa University: IALS Visiting Research Fellow

For details of further future events – including seminars in the Women’s Legal Landmark series – please access the IALS events listing page (<http://www.sas.ac.uk/support-research/public-events>).

# The regulatory power of international trade contracts over 19th century Dutch commercial sales law

by Janwillem Oosterhuis

---

## INTRODUCTION

How do national courts accommodate changing commercial practices out of which disputes arise? And how strong is the regulatory power of the contracts underlying these changing commercial usages? If various national courts develop similar rules to accommodate changing commercial practices, is that mainly because similar changes require similar solutions? Or are similar rules developed because these rules are for a regional, European market? This article will address these questions from a historical perspective: how responsive have national jurisdictions – and particularly the Dutch one – been to changing commercial practices in the 19th century? And have similar rules been developed because of similar problems or a shared, European market? In the latter case: how strong was then the regulatory power of international trade contracts?

The judicial response to certain changes in commercial sales practice in 19th century Europe will be analysed as a case study, ie a growing reliance on immediate default once a seller had failed to deliver in time and subsequently the market price rule to calculate the damages due. Immediate default and the market price rule can be related to the introduction of faster and more reliable means of transport, such as railways, but importantly also to the introduction of industrial production processes. First these changes will be highlighted in commercial sales law for the English, German and Dutch jurisdictions. It will appear that immediate default and the market price rule became entrenched in the English jurisdiction roughly between 1820 and 1840, in the German ones between 1840 and 1850, and in the Dutch jurisdiction between 1860 and 1870.

Following this enquiry, the adoption of immediate default and the market price rule within the Dutch jurisdiction will be analysed for its responsiveness to changes in commercial sales practice and whether this response had been developed independently and/or for a regional, European market. Using 19th century statistics about external trade and judicial statistics on commercial disputes, the entrenchment of

immediate default and the market price rule will be related to the overall increase in trade and the ensuing commercial cases in the Dutch jurisdiction; the final question will be whether this increase in commercial cases was concentrated in courts of commercial cities with a regional or international interest. If, for instance, the adoption of immediate default and the market price rule took place simultaneously or shortly after a strong increase of commercial cases, concentrated in regional or international commercial centres, this would indicate that such a jurisdiction might be highly responsive to changes in commercial (sales) practice within a regional, European market. Investigation of the Judicial Statistics for the Kingdom of the Netherlands seems indeed to indicate a strong responsiveness of Dutch courts in the context of a European market.

## CHANGES IN 19TH CENTURY COMMERCIAL SALES LAW: IMMEDIATE DEFAULT AND THE MARKET PRICE RULE

Damages as a remedy for breach or non-performance of commercial sales have certain characteristics under the common law, among which the absence of the requirement of a notice of default and a preference for a so-called abstract assessment of damages, commonly referred to as the market price rule (G H Treitel, *Remedies for breach of contract: a comparative account*, (Oxford, 1988) 114, 130, 136-38). Damages as a remedy in – inter alia – German and Dutch commercial legal practice developed similar features during the nineteenth century. In cases where the contract of sale fixed a date of delivery, no notice of default was necessary if a seller failed to deliver in time. The buyer could then immediately claim damages, generally by taking the difference between the original purchase price and the market price of the goods on the contractual date of delivery (J Oosterhuis, *Specific Performance in German, French and Dutch law in the nineteenth century: remedies in an age of fundamental rights and industrialisation*, (Leiden 2011) 237-309, 323-77).

In the English, German, and Dutch jurisdictions, the

immediate default and market price rule became characteristics of damages in commercial sales laws in the course of the eighteenth and nineteenth centuries. These similar characteristics of damages in common law and German and Dutch nineteenth century commercial legal practice can be related to similar, economic origins (see in detail J Oosterhuis, “Damages and the Industrial Revolution in England, Germany and the Netherlands – Damages as Remedy in 18th and 19th century European Commercial Sales Law”, 22/4 ZEuP (2014) 793-823).

In England, the market price rule was already developed in the late 1760s but became firmly entrenched in the law of damages between 1820 and 1840. This development probably ran parallel to a further acceptance of immediate default as a characteristic of damages as a remedy. It is submitted that the growing use of the market price rule for the assessment of damages for England, particularly since the 1820s, is related to a vast increase in international and domestic trade, better means of transport, and thus the emergence of (inter) national markets. These markets enabled litigants and courts to assess an award for damages on the basis of the difference between the purchase price and the market price at the date of the debtor’s default. However, England had known earlier periods of abundant foreign trade, for example from 1650 to 1750. The distinctive feature of the period between 1760 and 1840 seems to be the gradual industrialisation of English society, more specifically production processes (see in detail Oosterhuis, 22/4 ZEuP (2014) 795-804).

The relationship between the emergence of (inter)national markets and particularly industrialisation of production on the one hand, and the market price rule and immediate default as characteristics of damages on the other hand, is even more prominent in the German and Dutch jurisdictions. During the nineteenth century, due to, inter alia, liberalisation of trade and better means of transport, interregional and international markets for generic goods with daily fluctuating prices emerged in these civil law jurisdictions. The development of the market price rule in the German Confederation in the 1840s and 1850s and in the Netherlands in the 1860s and 1870s, ran parallel to a subsequent exponential increase in domestic and international trade: in the German Confederation since the 1840s, and in the Netherlands since the 1860s. However, not only did trade increase in the German Confederation and the Netherlands, but it also changed in nature. Due to the industrialisation of society, goods were starting to be used on a different scale and in different production processes. For the German territories, this industrialisation of production is most prominent for the iron industry in the 1840s and 1850s, whereas for the Netherlands, the industrialisation of the cotton industry since the 1860s is exemplary. These vast social and economic changes made it important not only that delivery took place, but also when delivery took place. The remedy of *Specific Performance* was no longer adequate for a buyer who needed to have the goods on time, either for the purposes of re-delivery or for their use in an industrial production process. Instead, the buyer would make a covering purchase and/

or recover his damages from the seller at a later time. It is submitted that immediate default upon the lapse of a delivery date as a characteristic of damages in commercial sales law is thus related to the emergence of a modern economy in Germany since the 1840s, and in the Netherlands since the 1860s. For the German territories immediate default and the market price rule were eventually laid down in Article 357 of the *Allgemeines Deutsches Handelsgesetzbuch*, whereas for the Netherlands these changes were reflected in judicial decisions during the 19th century (see in detail Oosterhuis, 22/4 ZEuP (2014) 804-813 (Germany), 813-821 (the Netherlands)).

It is thus submitted that immediate default and the market price rule as characteristic features of damages in English, German, and Dutch commercial legal practice are indeed related to similar economic changes, most prominently to the industrialisation of production processes, but also to a vast increase in interregional trade of generic goods, and a general availability of fast and reliable means of transport.

### CHANGING PRODUCTION PROCESSES OR INCREASING INTERNATIONAL TRADE?

These changing characteristics of damages in commercial sales law, ie immediate default and the market price rule, can thus importantly be attributed to pressure from two sides: a more internal pressure, ie adapting the rules to changing production processes, and a more external one, ie adapting the rules to changing international commercial practice. These two developments are obviously linked – international commercial parties also react on changing production processes in the first place. But they can nevertheless be distinguished to a certain extent as well by looking at the parties to a commercial sales contract: importantly, whether both parties are traders or that at the least the buyer is a merchant and not for instance an end-user, such as a factory owner. In the context of this contribution, the author is mainly interested in the pressure of international trade in changing certain rules, or put it differently, in the regulatory power of international commercial contracts.

### CHANGES TO DAMAGES AS A REMEDY IN 19TH CENTURY DUTCH COMMERCIAL SALES LAW

To illustrate the influence – or regulatory power – of international sales contracts on a certain jurisdiction, the Netherlands will be taken as an example, because the Dutch had been the last to incorporate immediate default and the market price rule in its commercial sales law. To distinguish the respective pressures of changing production processes and increasing international trade, the incorporations of immediate default and the market price rule as characteristics of Dutch commercial sales law – briefly sketched in the first section – will be elaborated in more detail. Particular attention will be paid to the parties to a contract.

#### *Specific date of delivery*

Trade sales which took place at a commodity exchange obviously regarded timely delivery as being of the utmost importance (Arrondissements-Rechtbank (hereafter A-Rb) Dordrecht, 30 June 1845, confirmed Provinciaal Gerechtshof (hereafter Prov Gh) Zuid-Holland, 6 May 1846, *Weekblad van het Regt* (hereafter *W*) 764 (500 barrels of turnip oil); A-Rb Amsterdam, 3 February 1854, *W* 1550 (colza oil)). Yet, since the late 1840s, the same appeared to be true in respect of other trade sales of generic goods with fluctuating market prices: courts increasingly held a seller to be in default as soon as he failed to deliver in time, for example in cases concerning deliveries of rice (A-Rb Amsterdam, 10 December 1847, *W* 944), wood (A-Rb Amsterdam, 29 November 1848, *W* 989) and rubber (A-Rb Assen, 27 February 1854, *W* 1634, confirmed Prov Gh Drenthe, 16 December 1854, *W* 1663). In order to take optimal advantage of seasonal and market conditions in the sale of fungible goods, sellers often included fatal delivery dates. For example, the District Court Rotterdam ordered in 1854 a seller to pay his buyer's damages and loss of profit after he had failed to comply with his buyer's request for delivery of 20,000 hectolitre of coal from Mariemont, Belgium, before 1 December (A-Rb Rotterdam, 10 May 1854, confirmed Prov Gh Zuid-Holland, 24 December 1855, *W* 1715). In this case, most likely involving a Dutch merchant as buyer, a timely delivery was of the essence given that the market price of coal would probably increase during the winter, and thus any late delivery would prevent the yielding of any profit from that increase.

Although a certain date of delivery was not in itself a term due to which mere lapse a debtor would fall into default, increasingly from 1860 onwards (albeit gradually), parties to commercial sales of generic goods – such as cotton (A-Rb Almelo, 29 October 1862, *W* 2543) or raisins (A-Rb Amsterdam, 18 October 1865, *W* 2758) – did in fact claim rescission with damages as soon as their sellers failed to deliver on time. The latter dispute was between two merchants, but the first one was between an English trading company and a Dutch cotton mill.

### **Trade sales v “ordinary” sales**

This practice resulted in the emergence of a distinction between commercial trade sales – in which cases a specific date of delivery had to be included as a resolutive condition within the terms of the contract – and “ordinary” (trade) sales – in which cases the courts would generally presuppose the existence of a resolutive condition under Article 1274 of the *Burgerlijk Wetboek*. The distinction between the two came about in conjunction with a growing interest in commercial law after the introduction of the *Allgemeines Deutsches Handelsgesetzbuch* in 1861 (see Oosterhuis, *Specific Performance*, 355-56). In 1866, the District Court Amsterdam delivered two decisions in close succession which seemed to expound two slightly different interpretations of the exact meaning of the specific date of delivery in the context of a trade sale. The first case was very similar to those interpretations of Article 357 of the *Allgemeines Deutsches Handelsgesetzbuch* that the German

courts had given around the same time, since damages were considered the primary remedy. The Amsterdam court stated in it that if parties, at least in trading matters, had stipulated a delivery date within the contract and delivery had not taken place before its expiry, then the explicit resolutive condition operated in such a way that the contract had to be treated as expired. Here the obligation to deliver thus ceased to exist as delivery had not taken place in due time. This was contrary to ordinary sales in which a resolutive condition was only presupposed by the *Burgerlijk Wetboek*, and under which the seller's obligation continued until rescission was claimed. In both types of sale, a buyer could claim rescission with damages but, importantly, a court could not grant an additional time to perform in respect of a trade sales with a specific or fixed delivery date, and the buyer was not obliged to claim rescission in court (again, contrary to ordinary sales) (A-Rb Amsterdam, 3 January 1866, *W* 2783).

However, it seems that the notion of a contract expiring upon default due to the expiry of a fixed date gave rise to far-reaching consequences that were deemed intolerable in practice. The Amsterdam court refined its prior interpretation a few months later: it stated that if a seller was in default (*mora*) to deliver before a specific date of delivery, this did not mean that the entire sale had expired, but only that the buyer was no longer obliged to accept the belated delivery. The seller's obligations were still valid if he fell in default, but the buyer could then choose between actual performance and rescission with damages. Otherwise, the choice of whether to perform in time or not, and thus in turn whether his obligation would be binding or not, would rest entirely with the seller. However, if in trade matters a date of delivery was inserted into the contract, the condition to deliver within a certain time had to be classed as a resolutive condition, even though such a contract did not expire *ipso jure*. Here, the court declared that a sale of 300,000 coconuts, to be delivered before the end of October 1864, was rescinded and ordered the seller to pay damages to his buyer in Le Havre, France (A-Rb Amsterdam, 21 March 1866, *W* 2809. The court had to apply the *Code civil* in this case; Article 1139 *Code civil* is equivalent to Article 1274 *Burgerlijk Wetboek*). Contrary to the previous case from 1866, this dispute most likely concerned two merchants.

### **Immediate default and rescission ipso jure**

According to Isaac Abraham Levy (1836-1920), an Amsterdam commercial lawyer, the principle *dies interpellat pro homine* was embodied in Article 1274 of the *Burgerlijk Wetboek*, and a notice of default was thus unnecessary in a sale with a specific date of delivery, just as it was under Article 357 of the *Allgemeines Deutsches Handelsgesetzbuch* (J.A. Levy, *Het algemeene Duitse handels-wetboek, vergeleken met het Nederlandsche wetboek van koophandel*, Amsterdam 1869, Art 357, n 1, 311-12). Indeed, after it became customary for traders to include a specific date of delivery in trade sales of generic goods and to claim damages upon its lapse, most courts held that the consequence of the lapse of such a date would be immediate default. In 1871, the District Court Rotterdam stated that

even if one did not assume that the mere lapse of time brought about a seller's default in trade sales of generic goods with a specific or fixed date of delivery or shipment, at the very least a buyer would not be obliged to accept what was delivered after that date (A-Rb Rotterdam, 11 December 1872, *W* 3538). If a party was in default on the basis of the contract itself, a separate notice was then unnecessary to establish his default. Thus a claim for rescission under Article 1303 of the *Burgerlijk Wetboek* did not necessarily have to be preceded by a notice of default. In 1880, the District Court Den Haag stated that this would particularly be the case in respect of the sale of fungible goods – in this case flour – whereby the insertion of a specific period for delivery would usually have the effect of holding the debtor in default upon mere lapse of the period (A-Rb 's-Gravenhage, 7 May 1880, *W* 4521): here the parties were a flourmill and a baker respectively.

Around 1880, it thus may be said that the majority of courts started to treat a resolute condition, including a fixed date of delivery, as a fatal term, ie one that would bring about an end to the agreement and justify rescission *ipso jure* (see Oosterhuis, *Specific Performance*, 359-61). Not only was a seller immediately in default as soon as he failed to deliver on time, but the contract was also considered rescinded from the moment of default. Consequently, it seems that Dutch legal practice had adopted a similar approach towards a contract of delivery (*Kauf auf Lieferung*) or trade sale with a fixed date of delivery (*Fixgeschäft*) as had been taken in the context of Article 357 of the *Allgemeines Deutsches Handelsgesetzbuch* some 20 years earlier. Damages (in the form of the price difference) had assumed for such trade sales the position of the creditor's primary remedy.

### Market price rule

The underlying concept of the market price rule lay in the difference between a buyer's purchase price and the market price at the date of his seller's default. Thus it became essential to establish when the seller was actually in default. As has been discussed above, prior to 1860 courts generally did not consider a contractual date of delivery in itself to be a fatal or fixed term, the failure of which would result in the creditor being declared in default immediately. There are examples of judicial decisions that, *per contra*, considered the inclusion of a certain date of delivery as being fixed and held a seller to be in default as soon as he failed to deliver in time. Such decisions also held the contract to be rescinded *ex tunc* and calculated damages on the basis of the difference between the purchase price and the market price on that contractual, fixed date of delivery (A-Rb Amsterdam, 10 December 1847, *W* 944).

Nevertheless, prior to 1860, non-defaulting parties regularly contended that they could choose a date other than that on which the seller's default took place in the assessment of damages by way of price difference. They argued that the defaulting party should have to pay the difference between the purchase price and the price on a date following the seller's default that suited them more favourable, including: the highest market price before the summons; the highest market price after the summons; the highest price prior to

the date of resale; or the date of resale itself; the date of the verdict in which rescission was established (see, for instance, judicial decisions from 1850, 1851, 1854 and 1858 before the Amsterdam District Court and Court of Appeal respectively, *Magazijn van Handelsrejt* 2 (1860), 46-57). Thus, as was the practice of litigants in the German territories, buyers often sought to choose the date at which the goods were at their highest market price (see also Levy, *Handels-wetboek*, Art 357, n 1, p 312).

However, from around 1860, the courts explicitly rejected this kind of arbitrary calculation of the price difference. In 1863, in a dispute between two merchants, the District Court Amsterdam stated that if a buyer claimed actual performance and a seller still failed to deliver, the latter had to pay the difference between the purchase price and the market price at the contractual date of delivery (A-Rb Amsterdam, 11 July 1863, *W* 2513). Yet it was perhaps only after 1870 that the payment of the price difference between the purchase price and market price at the fixed date of delivery became the standard means of assessing damages (A-Rb Rotterdam, 18 April 1866, *W* 2821 (merchants); A-Rb Rotterdam, 28 May 1866, *W* 2826 and A-Rb Rotterdam, 20 November 1867, *W* 3001 (merchants); Prov Gh Noord-Holland, 18 February 1869, *W* 3150). From 1870 onwards, Dutch courts regularly used the price difference as the standard means of establishing a buyer's damages if his seller failed to deliver on time. Moreover, this appeared to correspond with the growing judicial trend of viewing the contractual date of delivery as being a fixed date of delivery. Such cases concerned trade sales of all kind of goods with a market price, including: meat (A-Rb Maastricht, 28 May 1874, Prov Gh Limburg, 8 February 1876, *W* 3999), Union Pacific railway stocks (A-Rb Amsterdam, 15 June 1876, *W* 4024), and "good fair Dhollerah" cotton (A-Rb Almelo, 2 April 1879, Gh Arnhem, 25 February 1880, *W* 4522) – although the last dispute knew a cotton mill as buyer. The underlying rationale was simply that a seller who failed to deliver should not be able to profit from an increase in the market price.

Since around 1875 therefore, when trade sales concerned generic goods with a fluctuating market price and a specific date of delivery was included within the terms of the agreement, the seller was held to be immediately in default upon lapse of the due date – in that case the contract was rescinded *ipso jure* and the buyer could essentially only obtain the price difference.

### Primary influence of international trade sales

From the above overview, it can be observed that in most disputes with known parties, those indeed concerned merchants. This suggests that for the Netherlands, international trade has indeed decisively pushed towards the incorporation of immediate default and the market price rule as characteristics of damages in Dutch commercial sales law – more than the changing production processes, visible where cotton mills act as buying parties. Moreover, most of the disputes were parties relied on immediate default and/or the market price rule to establish their damages, were adjudicated before

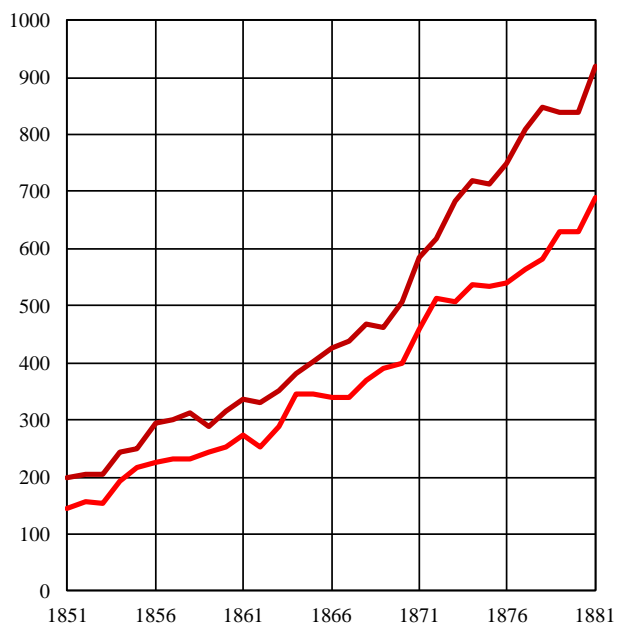


the Amsterdam and Rotterdam District Court respectively: Amsterdam and Rotterdam being important international trading centres.

### LOCATING THE INFLUENCE OF INTERNATIONAL TRADE ON 19TH CENTURY DUTCH COMMERCIAL SALES LAW

But how strong has this influence of international trade on Dutch commercial sales law been? Or, put differently, what has been the regulatory power of the underlying commercial sales contracts? The above overview indicates that this power has been exercised most decisively between around 1865 and 1875. It appears that the period 1865-75 coincides with a period of (strongly) increasing external trade of the Netherlands (on the fundamental problem of statistical identification in modern empirical economics, see E Helland & J Klick, “Legal Origins and Empirical Credibility” in M Faure & J Smits (eds), *Does Law Matter? On Law and Economic Growth*, (Antwerp, 2011) 99-113, here 108-9). The external trade of the Netherlands increased steadily during the 1860s but particularly in the course of the 1870s (graph 1).

Graph 1: Dutch external trade 1851-1881 in million guilders



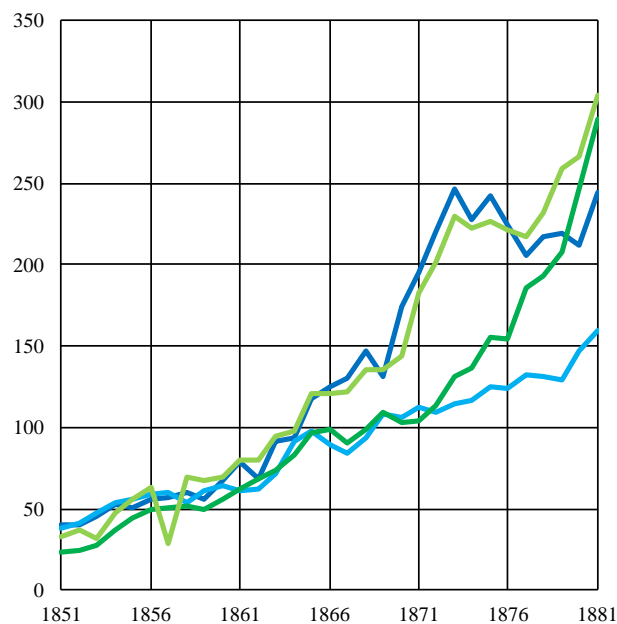
External Trade Aggregate Current Value: Import (dark red) / Export (light red)

Source: derived from B R Mitchell, *European Historical Statistics 1750-1970*, London 1975, 490, 540-41.

Moreover, closer inspection of the external trade with the UK and Germany confirms this picture: a steady increase in trade during the 1860s and a growth spurt in the 1870s (graph 2). Importantly, there is a trade surplus with Germany: exporting Dutch sellers might have wanted to accommodate their importing German purchasers. That would mean additional exposure to German-styled sales contracts, including immediate default and the market price rule.

Graph 2: Dutch external trade with the UK and Germany 1851-

1881 in million guilders



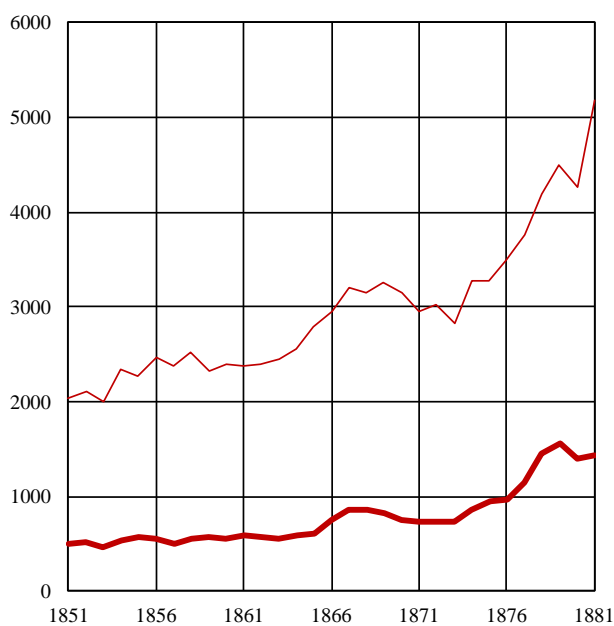
External Trade (value) UK: Import (dark blue) / Export (light blue)

External Trade (value) Germany: Import (dark green) / Export (light green)

Source: derived from B R Mitchell, *European Historical Statistics 1750-1970*, London 1975, 540-41.

Unfortunately, no separate statistics on the number of disputes about international commercial sales before Dutch district courts are available. The statistics that are available, nevertheless suggest that the higher amount of external trade was indeed translated in a higher number of (commercial) disputes. In the first place, there is an increase in the overall number of disputes including the number of commercial disputes (graph 3). Although these commercial disputes include a large variety of commercial disputes, for instance about agency contracts, accounting books, company rules, etc. and not only commercial sales, they can still serve as a proxy for commercial sales disputes, because the underlying commercial activities are often related to trade.

Graph 3: Final decisions by Dutch district courts 1851-1881



Overall Total Amount (thin red line)

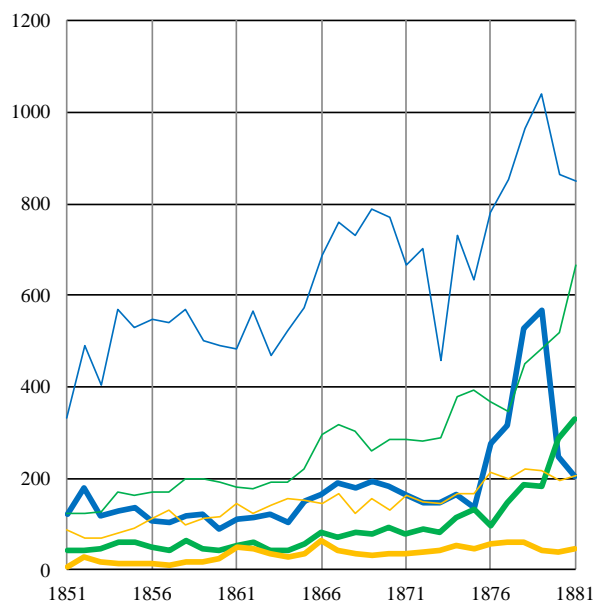
Commercial Cases (thick red line)

Source: derived from *Geregtelijke Statistiek van het Koninkrijk der Nederlanden 1851-81*.

The number of commercial disputes depends importantly on the amount of commercial activity, and as a derivative of commercial activity the ensuing increase in commercial disputes is less prominent. Moreover, the effect of increasing trade only has a delayed effect on the number of commercial disputes. This can also be observed for the increase in final decisions in commercial disputes before certain Dutch district courts. As from the mid-1860s a slight increase in the overall number of commercial disputes can be observed; from the mid-1870s a stronger increase in commercial disputes can be observed.

An increase in commercial disputes as such does, however, not mean a similar or proportionally larger increase of international commercial disputes. Therefore the author has looked at whether the amount of commercial disputes increased stronger in international commercial centres, notably Amsterdam and Rotterdam, compared to the overall increase in commercial disputes, but also to a more local district court, Maastricht (graph 4).

Graph 4: Final decisions by the Amsterdam, Rotterdam and Maastricht district courts 1851-1881



Amsterdam: total (thin blue) / commercial (thick blue)

Rotterdam: total (thin green) / commercial (thick green)

Maastricht: total (thin yellow) / commercial (thick yellow)

Source: derived from *Geregtelijke Statistiek van het Koninkrijk der Nederlanden 1851-81*.

The increasing exposure to international commercial contracts seems indeed to correspond with more international commercial disputes, as district courts in the international market centres (Amsterdam, Rotterdam) gain importance at the cost of local ones (Maastricht).

Roughly between the mid-1860s and the mid-1870s, Dutch courts – notably the Amsterdam and Rotterdam District Courts – incorporated immediate default and the market price rule as characteristics of damages within Dutch commercial sales. This period of judicial incorporation coincides with a strong increase in international trade with the UK and Germany, particularly as from the 1870s. Rather, the increase in trade on its turn also coincides with a considerable increase in commercial disputes, notably before the Amsterdam and Rotterdam district courts: it can safely be assumed that there was thus also an increase in international commercial disputes. Taken together, these observations suggest that Dutch commercial sales law responded quite strongly to the regulatory power of the international commercial sales contracts, here exemplified by immediate default and the market price rule, because this response coincided with the strong increase of international trade and ensuing commercial disputes between the mid-1860s and mid-1870s.

## CONCLUSIONS

The incorporation of immediate default and the market price rule as characteristics of damages in the commercial sales laws of England, the German territories and the Netherlands, seems to be prompted importantly by a growing use of industrial production processes and increasing (inter) national trade during the 19th century. This supports the idea that changes in commercial practice importantly depend on exogenous economic changes and expanding markets. The

incorporation of immediate default and the market price rule as characteristics of damages in Dutch commercial sales law might be attributed to a significant exposure to disputes about international trade sales between the mid-1860s and the mid-1870s because of the growing trade with the UK and Germany. The responsiveness of a jurisdiction to the regulatory power of international commercial contracts therefore seems to depend importantly on the exposure to international trade and the ensuing disputes about the underlying commercial contracts.

**Janwillem Oosterhuis**

*Assistant Professor, Faculty of Law, Maastricht University*

# Harmonisation impossible? On the evolution of the English, French, and Bulgarian approach to hardship in commercial contracts

by Radosveta Vassileva

## INTRODUCTION

During the International Week of Comparative Law in Paris in 1937, one of the largest comparative events to date, which was organised by the French Association Henri Capitant, the key topic of discussion was hardship. The viewpoints of 14 jurisdictions were presented and a summary report was drafted. The chief *rapporteur* of the discussion, Jean-Paulin Niboyet, identified persistent disparities and classified the responses into two groups – those which allowed judicial intervention in case of hardship and those that did not (JP Niboyet, “La révision des contrats par le juge. Rapport général” in *Travaux de la Semaine Internationale du Droit* (Syrey 1937) 8-13). He referred to the former as the “Latin group” and to the latter as the “Continental group”.

France found itself in the non-interventionist camp due to its interpretation of good faith. In the “Continental group”, in Niboyet’s opinion, good faith required that promises be kept. While Niboyet did not explicitly discuss Bulgarian law, we will see below that Bulgaria had initially borrowed its law on obligations from France, so its approach was similar. By contrast, Niboyet argued that in the interventionist camp, good faith had acquired a social dimension which permitted contractual modification. He also asserted that the approach towards supervening events was directly linked to public policy (Niboyet 5). England, however, was placed in the middle of the spectrum of responses because of the doctrine of frustration. This doctrine emerged from the decision *Taylor v Caldwell* in which Blackburn J granted relief based on the implied condition theory ((1863) 3 B & S 826, 833). In the eyes of Niboyet, the implied condition theory allowed judges to modify contracts. This assertion, of course, can be criticised for, from an English perspective, implied conditions aim at giving effect to the parties’ intentions, so this approach complies with the

principle of “freedom of contract”.

Since then, the spectrum of responses towards hardship seems to have shifted: the sharp division between what was known as the Latin group (Romanistic legal family) and the Continental group (Germanic legal family) can no longer be discerned. The modern French, Bulgarian, and English approach do not correspond to the picture painted by Niboyet. Bulgaria progressively moved to the far end of the interventionist camp. It enacted a principle allowing judicial interference in agreements in instances of hardship, albeit with a limited scope, as Article 266, paragraph 2 of its Law on Obligations and Contracts (LOC) as early as 1950. It is one of the first jurisdictions in Europe to introduce such a principle in its legislation. Moreover, in 1996, amidst a severe economic crisis, the country enacted a general principle on hardship as Article 307 of the Law on Commerce (LC) under the title “Economic onerosity”. As discussed below, Bulgarian judges tend to interpret this provision generously.

By contrast, after a century of debate, France enacted the principle of *imprévision*, which allows judicial modification/termination in case of hardship, as Article 1195 of the *Code civil* only in 2016. In principle, French judges have been reluctant to develop a jurisprudential solution for civil contracts in contrast to their approach to administrative contracts. The two cases, which are traditionally distinguished, are *Canal de Craponne* in which the theory of *imprévision* was rejected for civil contracts and *Gaz de Bordeaux* in which it was allowed for administrative contracts (see D Mazeaud, “La révision du contrat. Rapport français” in *Le contrat: journées brésiliennes* (Société de la législation comparée 2008) 553-89; Y Lequette, F Terré and H Capitant, *Les grands arrêts de la jurisprudence civile*, (12th edn, Dalloz Bibliothèque, 2008) 183-92). That is why, historically, French legislators have intervened through temporary statutes,

such as the *Loi Faillot* (S Renner, *Inflation and the Enforcement of Contracts*, (Edward Elgar Publishing 1999) 15-17). In England, as explained below, the doctrine of frustration has also evolved, but to this day, courts are reluctant to apply it to instances of hardship.

This article examines the evolution of the approach to hardship in Bulgaria, France, and England to challenge the idea that the responses of national jurisdictions are converging and to shed light on the key role which context plays in doctrinal development and legal practice. This particularity seems important in view of initiatives aimed at harmonising contract law, such as the UNIDROIT Principles, the Principles of European Contract Law (PECL), the Draft Common Frame of Reference (DCFR), etc. Moreover, the author demonstrates the palpable differences in results, which these jurisdictions reach in similar circumstances. These discrepancies may have implications for international trade because the same parties may be confronted with different outcomes depending on the applicable law – France and the UK are some of Bulgaria’s key trade partners.

It should be clarified that in this article, the terms “hardship”, “supervening onerousness”, and “changed economic circumstances” are used as synonyms, unless indicated otherwise. In the Bulgarian legal tradition, the principle addressing these difficulties is known as “economic onerosity”.

## HISTORICAL BACKGROUND

As mentioned above, Bulgaria is one of the first jurisdictions in Europe to enact a principle on hardship in its legislation. While Germany was the first jurisdiction to address the problem of changed economic circumstances in the aftermath of World War I with a jurisprudential solution, a concrete legislative provision was enacted only in 2001 as section 313 of the *Bürgerliches Gesetzbuch* (A Janssen and R Schultze, “Legal Cultures and Legal Transplants in Germany” (2011) 2 *European Review of Private Law* 225, 232). In principle, Poland is recognised as the first jurisdiction to pass a legislative provision on hardship as Article 269 of its 1933 Code of Obligations (Alfons Puelinckx, “Frustration, Hardship, *Force majeure*, *Imprévision*, Wegfall der Geschäftsgrundlage, Unmöglichkeit, Changed Circumstances” [1986] 3 *Journal of International Arbitration* 47, 54). Italy and Greece followed suit with their new civil codes of 1942 and 1946 respectively (see E Zaccaria, “The Effects of Changed Circumstances in International Commercial Trade” (2005) 9 *International Trade and Business Law Review* 135, 147-49; PJ Zepos, “Frustration of Contract in Comparative Law and in the New Greek Civil Code of 1946 (Article 388)” (1948) 11 *Modern Law Review* 36-46). Bulgaria quickly walked in their footsteps.

### *Time of parting with the French model*

The factors, which led to the evolution of the Bulgarian approach to hardship, are particularly interesting from a

comparative perspective because Bulgaria borrowed its first LOC of 1892 indirectly from the French *Code civil* (see “Economic Onerosity in Context: Particularities and Development of Bulgarian Law” in R Vassileva, *Change of Economic Circumstances in Bulgarian and English Law. What Lessons for the Harmonization of Contract Law in the European Union?* (Doctoral Thesis, University College London, 2016) at ch 2). Bulgarian jurists were fascinated by French law, which they considered as a viable legal model for the country. Their enthusiasm, however, quickly faded away. The French reluctance to enact a general principle on hardship triggered a rebellion against the French model, which eventually resulted into a major reform of Bulgaria’s law on obligations – a new LOC was enacted in 1950. Whilst the reform was carried out after Bulgaria became a communist country, one can identify its seeds in the scholarly activism from the interwar period.

For instance, in his article “*Vis Major*” of 1921, the Bulgarian scholar Nisim Mevorah argued in favour of recognizing changed economic circumstances as a permanent *force majeure* (Nisim Mevorah, “*Vis Major* (Legal Archive)” [2002] 5 *Turgovsko pravo* 559). He was particularly troubled by the effect of World War I on contracts:

*There is a huge gap between 1914 and 1921 in which, along with a lot of bones and blood, rest all our units of measure... to accept that the increased difficulty of performance has no importance means to bankrupt many tradesmen and to turn commerce into gambling with the chance impoverishments and enrichments that are typical of such a game* (Mevorah 562).

He suggested that changed circumstances had to have the same effect as a permanent *force majeure* – terminate the contract – and that the degree of difficulty had to be evaluated on a case by case basis (Mevorah 564). In this way, Bulgarian law could achieve “flexibility and the highest possible justice which is different from dry formulations and Latin texts gone yellow” (Mevorah 564). In principle, at the time, war was treated as a temporary *force majeure*, which suspended performance, but once the war was over, performance was due although it was overly burdensome.

However, it was through the work of Lyuben Dikov, a leading Bulgarian authority, that a radical change of attitude was induced in Bulgaria. He had dedicated a significant part of his research to *clausula rebus sic stantibus* since 1923 (see *Historical and Comparative Research on Mistake in the Law of Inheritance, Clausula Rebus Sic Stantibus in Private Law and the Essence of Adjudication*, Sofia 1923). By the end of the 1930s, he had also rethought the philosophical foundation of contract to suggest ways in which the principle could be properly integrated not only in Bulgaria, but also elsewhere (L Dikov, “*Norma giuridica e volontà privata*” (1934) 14 *Rivista internazionale di filosofia del diritto* 681-706; L Dikov, “*L’évolution de la notion de contrat*” in *Études de droit civil à la mémoire de Henri Capitant*, (Daloz, 1939) 201-18). Dikov was convinced that the French *Code civil* was “too old and outdated” and that the liberal individualist philosophy, which underpinned it, was inadequate to society’s needs (L Dikov, *Morality and Law*, (Sofia 1934) 15-

16). The reports of the International Week of Comparative Law in Paris in 1937, referred to above, enraged him and provoked him to write an article, which is highly critical of the liberal individualist model of contract and of Niboyet's "simplistic" assertions about the differences between the various jurisdictions (L Dikov, "Die Abänderung von Verträgen durch den Richter" in *Hedemann-Festschrift* (Jena 1938)). Dikov argued that the approach towards modification in case of supervening onerousness was neither a question of public policy nor of interpretation of the principle of good faith, but of fundamental differences regarding the nature of contract. Dikov was interested in organic social theory and believed that society and the individual were interdependent just like the cells and the human body, so the judge had to intervene in the name of society when the relationship between two cells could harm the body (for an overview of his contract law theory, see R Vassileva, "Contract Law and the Social Contract: Rethinking Law Reform in the Field of Contract Law from the Perspective of Social Contract Theory", (2016) LXV(III)(11) *Pravni zivot* 270-75).

The authors of the 1950 LOC, which is still in force following cosmetic amendments in the early 1990s, were influenced by Dikov's work. That is why, it is highly likely that as a nod to Dikov, they included a provision on changed economic circumstances in this piece of legislation (see "Economic Onerosity in Context: Particularities and Development of Bulgarian Law" in R Vassileva, *Change of Economic Circumstances in Bulgarian and English Law. What Lessons for the Harmonization of Contract Law in the European Union?* (Doctoral Thesis, University College London, 2016) at ch 2). In fact, since Dikov was fascinated by Italian law, they based the 1950 LOC on sections of the original Italian *Codice civile* of 1942, which is striking considering the ideological differences between Bulgaria and Italy at the time. This is how Article 266, paragraph 2 of the LOC pertinent to manufacturing contracts only was introduced:

*If in the course of the performance of the contract the duly determined prices of materials or labour change, the compensation shall be adjusted accordingly, even where it was agreed upon as a total sum.*

This is almost a verbatim copy of Article 1664 of the Italian *Codice civile*: "If, by reason of unforeseeable circumstances have occurred increases or decreases in the cost of materials or labour, such as to cause an increase or decrease greater than one-tenth of the total agreed price, any contractor may request a review of the same price. The review may be granted only for the difference that exceeds the tenth ..." The main difference between the two provisions – the Bulgarian one does not stipulate a threshold of change – can be explained with the fact that the drafters took context into consideration. In communism, the economy is planned and prices are fixed by the government.

In 1996, Bulgaria enacted a general principle on hardship as Article 307 of its LC:

*A court may, upon request by one of the parties, modify or*

*terminate the contract entirely or in part, in the event of the occurrence of such circumstances which the parties could not and were not obliged to foresee, and should the preservation of the contract be contrary to fairness and good faith.*

Bulgaria has an autonomous commercial law, but the LOC and the LC are considered subsidiary, so the provision is applicable to civil agreements too. It is also interesting that in the same year, Bulgaria enacted a similar provision pertinent to agricultural tenancies only. Article 16, para 1 of the Law on Agricultural Tenancy states: "If circumstances that the parties did not consider at the time of entry into contract modify and induce non-equivalence of their obligations, any of the parties may demand contract modification ...".

What may be striking for the Western European reader is that these provisions, which clearly give judges the power to modify and/or terminate contracts without the consent of both parties, were introduced without much debate. Generally, contemporary Bulgarian scholarship has not questioned these powers, which may appear overly interventionist both from an English and a French perspective. It is likely that English lawyers criticise such provisions from the perspective of "freedom of contract". In turn, we will see below that the new French Article 1195 is rather safely worded by comparison to the Bulgarian provisions.

### *France and England beg to differ*

Considering the discussion above, it is important to highlight the stark contrast between Bulgaria and West European jurisdictions like France and England. Notably, it took France almost 70 more years than Bulgaria to introduce a principle on changed economic circumstances. The move was more controversial, too. The so-called solidarist movement represented by scholars like François Géný, Léon Duguit, Emmanuel Gounot never took solid ground. It has been observed that contractual solidarity was not embraced by the French courts (J Cédras, "Le solidarisme contractuel en doctrine et devant la Cour de cassation" in *Rapport 2003 de la Cour de cassation*, (la Documentation française, 2004) 186-204).

Regarding the doctrine of *imprévision*, one could observe a change of attitude in some decisions by the French *Cour de cassation* as late as the 1990s. Scholars have identified case law in which the French court awarded damages to a party, which experienced excessively onerous performance, because the other party refused to renegotiate. It was deemed that this violated the principle of good faith (see D Mazeaud, "Le droit européen des contrats et ses influences sur le droit français" (2010) 1 *European Review of Contract Law* 10-12; M Fabre-Magnan, *Droit des obligations: 1 – Contrat et engagement unilatéral* (PUF 2016) 557-58). However, this was a compromise solution because it did not involve direct judicial intervention in the agreement. Moreover, these cases involve distributorship agreements and commercial agencies for which there are higher standards of loyalty and cooperation.

French scholars continue to be divided about the merits of the theory of *imprévision*. It is interesting to note that prior to the enactment of the Ordonnance in 2016, there were two main scholarly proposals for reform: the 2005 *avant-projet Catala* and the 2009 *avant-projet Terré*. While the *avant-projet Catala* does not accord the judge the right to modify agreements in case of changed economic circumstances (Article 1135-1), the *avant-projet Terré* does (Article 92). The tension between these two views could be seen in the rather safe way in which the new provision 1195 of the *Code civil* is worded:

*If a change of circumstances that was unforeseeable at the time of the conclusion of the contract renders performance excessively onerous for a party who had not accepted the risk of such a change, that party may ask the other contracting party to renegotiate the contract. The first party must continue to perform his obligations during renegotiation.*

*In the case of refusal or the failure of renegotiations, the parties may agree to terminate the contract from the date and on the conditions which they determine, or by a common agreement ask the court to set about its adaptation. In the absence of an agreement within a reasonable time, the court may, on the request of a party, revise the contract or put an end to it, from a date and subject to such conditions as it shall determine.*

Unlike the Bulgarian Article 307, the French provision specifically mentions negotiations. The legislator says that the party “may” negotiate instead of “must” negotiate, which seems to indicate that this is optional. Meanwhile, the provision seems to encourage parties to attempt negotiations before approaching the court because, if that was not important for the legislators, they could have skipped the reference to negotiations altogether. Furthermore, the French provision explicitly mentions that the change should not have been accepted as risk by one of the parties whereas the Bulgarian provision unequivocally puts a strong emphasis on fairness and good faith. Below, we will see that in the Bulgarian legal tradition, fairness and good faith are powerful tools for addressing substantive unfairness in agreements. By contrast, considering the traditional reluctance of French judges to relieve parties from onerous performance, it seems early to say how comfortable French judges would be in exercising their powers envisaged under Article 1195.

Finally, it may be helpful to note that at the time Bulgarian scholars were vocal about the necessity to develop a rule on hardship, English courts showed firm commitment to the sanctity of contract and freedom of contract. For example, in *Tennants (Lancashire) v CS Wilson, Earl Loreburn* underlined: “The argument that a man can be excused from performance of his contract when it becomes ‘commercially impossible’ ... seems to me a dangerous contention which ought not to be admitted unless the parties have plainly contracted to that effect” ([1917] AC 495, 510). Similarly, in *Blackburn Bobbin v TW Allen*, McCaig J stressed the “utmost importance to a commercial nation that vendors should be held to their business contracts” ([1918] 1 KB 540, 552). He further declared:

*There is here no question of illegality or public policy... There is merely an unforeseen event which has rendered it practically impossible for the vendor to deliver. That event the defendants could easily have provided for in their contracts. If I approved the defendants’ contention, I should be holding in substance that a contract which did not contain a war clause was as beneficial to the vendor as a contract which contained such a provision ([1918] 1 KB 540, 551).*

This approach continues to inform judicial attitudes towards hardship today. In principle, the doctrine of frustration has evolved. The current application test, which emerged from *Davis Contractors Ltd v Fareham UDC*, requires that circumstances become “radically different” from the time of entry – a very high threshold, so unsurprisingly courts have not applied the principle to instances of hardship so far ([1956] AC 696, 729). Case law demonstrates that frustration may encompass diverse supervening events: the doctrine may be applicable in instances of, for example, destruction of subject-matter, unavailability of the subject-matter or something essential for the performance, and illegality (see *Appleby v Myers* (1867) LR 2 CP 651; *Pioneer Shipping Ltd v BTP Tioxide Ltd (The Nema)* [1982] AC 724; *Fibrosa Spolka Ackcyjna v Fairbairn, Lawson Combe Barbour Ltd* [1943] AC 32). Moreover, judges take into consideration fault and foreseeability – the supervening event should not be due to the act or election of the party seeking to rely on it and it should be unforeseen/unforeseeable (*Davis Contractors AC 696, 729; Edwinton Commercial Corporation, Global Tradeways Ltds v Tsavliris Russ (The Sea Angel)* [2007] 2 Lloyd’s Rep 517 [127]). One may argue that the scope of frustration remains very narrow because of its drastic consequences: the contract is terminated automatically at the time frustration occurs irrespective of the parties’ wishes (*National Carriers v Panalpina* [1980] AC 675, 712).

However, English courts encourage parties to distribute risk and to determine the consequences of supervening events by themselves by inserting detailed *force majeure*/hardship clauses (E McKendrick, “*Force majeure* Clauses: The Gap between Doctrine and Practice” in A Burrows and E Peel (eds), *Contract Terms*, (2nd edn, OUP, 2009)). By contrast, it is interesting that empirical research has shown that inserting detailed hardship clauses is not common in France (C Kessedjian, “Competing Approaches to *Force majeure* and Hardship” (2005) 25 *International Review of Law and Economics* 415, 421). While similar research has not been carried out in Bulgaria, considering the various provisions envisaged in legislation, it is unlikely that hardship clauses are too common.

## LEGAL PRACTICE: PERSISTENT DISPARITIES

It is important to underline that the differences between Bulgaria, France, and England are not merely on paper. One can also identify dissimilarities in legal practice, which reflect the diverging legal values of these jurisdictions. Bulgarian case law on hardship is not abundant, but the cases I have discovered amply illustrate the interventionist approach by Bulgarian courts, which sits in stark contrast to legal practice

in France and in England. Not only does Bulgarian law appear more invasive, but also judges do not shy away from using their powers, thus showing their commitment to promoting substantive fairness and social justice in contract law.

### Article 266, para 2 of the LOC

The contemporary application of this provision provides an opportunity for comparison with the leading English case on frustration *Davis Contractors* ([1956] AC 696). The case concerned a contract for the building of 78 houses for eight months at a fixed price of £94,424. There were shortages of labour and material and a long period of frost, which made performance more onerous for Davis. Completion slowed down: the houses were built in 22 months. Davis filed a claim arguing frustration and requesting payment on a *quantum meruit* basis. The actual cost of construction was £115,233 – approximately 22 per cent more costly for Davis. Davis Contractors' claim failed. The House of Lords held:

*In a contract of this kind the contractor undertakes to do the work for a definite sum and he takes the risk of the cost being greater or less than he expected. If delays occur through no one's fault that may be in the contemplation of the contract, and there may be provision for extra time being given: to that extent the other party takes the risk of delay. But he does not take the risk of the cost being increased by such delay* ([1956] AC 696, 724).

The case would have likely had a different outcome had it been examined in Bulgaria. As mentioned above, Article 266, paragraph 2 requires that the price in a contract be modified when the costs of labour and materials change had the price been agreed as a total sum. Moreover, it does not stipulate a threshold of change. From a Bulgarian perspective, construction contracts are manufacturing contracts, which are governed by several laws, including LOC's rules on manufacturing contracts. The definition of manufacturing contract in Article 258 of the LOC is rather broad, which permits the application of the rules on manufacturing contracts to diverse agreements: "Under a manufacturing contract, the contractor shall be liable at his own risk to manufacture something in accordance with the other party's order, and the latter – to pay a compensation."

Decision 1/2013 on com. c. 921/2011 by Bulgaria's Supreme Court of Cassation concerns facts reminiscent of *Davis Contractors*. A company and a local municipality entered into a construction agreement at a fixed price supposed to be paid in tranches. The company had delayed performance because of increased costs and the municipality withheld its last tranche to enforce a liquidated damages clause. While the lower courts held that the clause was enforceable, the Supreme Court of Cassation quashed their decision by virtue of Article 266, paragraph 2. The court held that since the price of materials and labour had increased, the municipality owed the company an additional payment, which it did not make. Hence, the court deemed that the municipality caused itself the delay in construction. The liquidated damages clause was unenforceable, and the municipality was ordered to pay the last

tranche with interest.

It is also helpful to clarify that under Bulgarian law, the long period of frost may be deemed as an insurmountable force, too. Bulgarian legislation distinguishes between two types of supervening impossibility – the chance occurrence (Art 196, para 1 of the LOC) and the insurmountable force, which reminds of the French doctrine of *force majeure* (Art 306 of the LC). Article 306(2) of the LC stipulates: "An insurmountable force shall be an unforeseen or unavoidable event of an extraordinary nature which has occurred after the conclusion of the contract".

Unlike the French criteria on *force majeure*, the Bulgarian criteria on the insurmountable force appear less stringent (see B Nichol, "Force majeure in French Law" in E McKendrick (ed), *Force Majeure and Frustration of Contract*, (2nd edn, Lloyd's Press, 1995) 24). Because the provision itself uses the conjunction "or", courts treat unforeseeability and unavoidability as alternative criteria (see Decision 6/2013 on com. c. 1028/2011 by Bulgaria's Supreme Court of Cassation). Moreover, courts seem to interpret the requirement for "extraordinary nature" rather generously, too. For example, in Decision 368/2008 on com. c. 661/2008, the Veliko Turnovo Appellate Court concluded that partial non-performance was due to severe drought which impeded the harvest of the quantity of grain stipulated in the contract of sale. In other words, in the eyes of a Bulgarian court, the period of frost may constitute an insurmountable force because the contractors could not prevent it or foresee it despite exercising good care. Hence, the delay, which resulted from the period of frost, could be excused.

Finally, French law does not have an equivalent provision to Article 266, paragraph 2 of the Bulgarian LOC. However, one may consider if, from a French perspective, the contract between *Davis Contractors* and the municipality is an administrative contract. The definition is complex and beyond the scope of this article but in these circumstances, one of the parties is a public entity and the contract's purpose may fall under the scope of public works, so the definition may be satisfied. If that is the case, one may consider if the precedent set in the *arrêt Gaz de Bordeaux* (1916) could be applicable. The *Conseil d'Etat* decided that the city of Bordeaux owed an indemnity to a concessioner which maintained the public lights in the city because the price of coal had increased five times since the time of entry, the price in the contract was no longer relevant to the new circumstances, and the change could not have been foreseen (see Y Lequette, F Terré and H Capitant, *Les grands arrêts de la jurisprudence civile* (12th edn, Dalloz Bibliothèque, 2008) 183-92). As noted above, however, the price for Davis increased by 22 per cent only, which means that the change is not as significant as the change addressed in *Gaz de Bordeaux*. Hence, it seems that the French response will be similar to the English response in these particular circumstances.



### Article 307 of the LC

As explained above, Article 307 is a recent addition to the interventionist arsenal of Bulgarian judges. It was enacted in a period of monstrous inflation: annual inflation was estimated at 338.5 per cent in 1991, 91.3 per cent in 1992, 72.9 per cent in 1993, 96.1 per cent in 1994, 62.1 per cent in 1995, 121.6 per cent in 1996, and 1058.4 per cent in 1997 (see K Tochkov and H Nath, “Relative Inflation Dynamics in the EU Accession Countries of Central and Eastern Europe” (Bulgarian National Bank, May 2011). Hence, one may be tempted to assume that it was meant to address extreme cases of supervening onerousness. However, two recent cases in which Article 307 of the LC was successfully applied provide food for thought about the important differences between Bulgaria and West European jurisdictions like England and France: Decision 50/2010 on com. c. 10/2010 by the Varna Appellate Court and Decision 240/2013 on com. c. 259/2011 by Bulgaria’s Supreme Court of Cassation. Both decisions concern long-term commercial lease agreements and involve similar facts. It is interesting that in the first case, the Varna Appellate Court (VAC) affirmed the application of Article 307. By contrast, in the second case the Supreme Court of Cassation quashed a decision by another chamber of the VAC, which had refused the application of Article 307.

Before examining these decisions, it is helpful to elaborate on the criteria of application which Bulgarian courts consider when examining cases on Article 307. Some of them stem from the provision itself. The rest are derived by analogy from other provisions in the law. The criteria, which derive from the provision are as follows: (1) One of the parties should file a claim in court. Unlike the English doctrine of frustration, Bulgarian economic onerosity does not have an “automatic” effect; (2) Parties could not and were not obliged to foresee the supervening event; (3) Following the event, the preservation of contract became contrary to fairness and good faith. By analogy to the rules on impossibility of performance, there are additional criteria – the aggrieved party should not be at default regarding the contract before the supervening event arises, lack of fault in producing the supervening event, the fundamental nature of the supervening event, performance should still be possible and incomplete, etc. It is generally believed that these criteria are cumulative (see I Staykov “Economic Onerosity of Performance of Business Transactions” [1997] 5 *Pazar i pravo* 19; E Mateeva, “Necessary Changes in the Principle of Economic Onerosity in Article 307 of the Law on Commerce” in *Contemporary Law – Problems and Tendencies* (Sibi, 2011) 234).

As mentioned above, there are important differences between the Bulgarian provision and Article 1195 of the Code civil. Unlike the French provision, the Bulgarian provision does not encourage parties to negotiate. Moreover, the French provision allows the parties to approach the court together while the Bulgarian provision encourages a unilateral decision by one of the parties to approach the court. Furthermore, Article 307 puts a strong emphasis on fairness and good faith. In Bulgarian law, the two notions overlap (see “The

Conceptions of Contract and Justice in Bulgarian and English Contract Law” in R Vassileva, *Change of Economic Circumstances in Bulgarian and English Law. What Lessons for the Harmonization of Contract Law in the European Union?* (Doctoral Thesis, University College London, 2016) at ch 4). What is important, however, is that fairness not only encompasses procedural fairness (the vitiating factors), but also substantive fairness. Unlike France, which deleted the reference to *la cause* in the *Code civil* with the 2016 reform, Bulgaria embraces the notion of “cause” both at the formation stage and the performance stage. Below we will see that in both cases in which Article 307 was successfully applied, the idea of equivalence of performance – what the promisor gives should be equivalent to what he receives – was a key factor. Bulgarian doctrine argues that this equivalence is subjective: if an agreement is the expression of free will, obligations are equivalent (A Kalaidjiev, *The Law of Obligations: General Part* (5th edn, Sibi 2010) 67). However, in the cases examined below, it seems that Bulgarian courts interpreted this requirement literally.

### Decision 50/2010

This case concerned the lease for a store selling luxury goods in a shopping centre. The VAC declared that the parties not only did not foresee that the number of clients would decrease several months after the mall’s opening, but also could not and were not obliged to foresee this fact at entry. It appears, however, that a leading factor motivating the decision was the contractual imbalance, contrary to fairness and good faith, which resulted from an objective change of economic circumstances. The court established that the revenue of the store was “several times less” than the rent and that the cause of low revenue was an economic crisis: “The effects of the world economic crisis were felt ... at the end of 2008 ... The analysis of the facts shows that at the end of 2008 when the claim was registered, the claimant had objective difficulties in performing his contractual obligations ...” It should be noted that the parties had entered negotiations and the lessor had proposed to decrease the rent by 20 per cent. The court, nonetheless, concluded that “the lessor’s proposal ... was inadequate to the loss suffered by the lessee”. The court deemed that all necessary conditions for application of Article 307 were present and terminated the agreement as requested by the claimant.

It seems likely that English law would reach a different result if confronted with the same case. In evaluating whether the doctrine of frustration was applicable, English judges would examine whether the supervening event (the alleged economic crisis) had radically altered the contractual obligation and whether the parties intended to preserve the contract in such circumstances. The lease agreement was entered into during the first half of 2007. Official statistics show that the yearly inflation rate in Bulgaria was estimated at 12.5 per cent in 2007 and 7.8 per cent in 2008. By contrast, in 2006 it was 6.5 per cent (see press release by Bulgaria’s National Institute of Statistics [http://www.nsi.bg/sites/default/files/files/pressreleases/Inflation\\_god2011.pdf](http://www.nsi.bg/sites/default/files/files/pressreleases/Inflation_god2011.pdf)). Objectively,

there was a macroeconomic change which could be proven in court. However, it is difficult to argue that this change was “radical” and that it made the lessee perform something that he had not promised. The judgment does not make references to the clauses in the agreement, so for the purposes of our comparison, we can assume the lessee either had not assumed the risk of inflation or he had assumed standard inflation targeted by the central bank. In both circumstances, it seems unlikely that English judges would conclude that the inflation change of 6 per cent (between 2006 and 2007) radically altered the promisor’s obligations – to pay rent in this case. On the contrary – this change seems to fall under standard merchant risk.

English judges traditionally support the principle of nominalism for domestic contracts (D Fox, “The Case of Mixt Monies: Confirming Nominalism in the Common Law of Monetary Obligations” (2011) 70 *Cambridge Law Journal* 144-174). According to this principle, where a debt is expressed in pounds, the debtor is bound to pay the nominal amount irrespective of the currency’s depreciation or appreciation due to inflation/deflation. For instance, in *Treseder-Griffin v Co-operative Insurance Society Ltd*, Lord Denning emphasised:

*In external transactions it is...quite common for parties to protect themselves against a depreciation in the rate of exchange by means of a gold clause. But in England we have always looked upon a pound as a pound, whatever its international value. We have dealt in pounds for more than a thousand years – long before there were gold coins or paper notes. In all our dealings we have disregarded alike the debasement of the currency by kings and rulers or the depreciation of it by the march of time or events* ([1956] 2 QB 127, 144).

Similarly, in *Wates Ltd v GLC*, it was concluded that there was no frustration although the contract had become “more expensive and onerous ... because inflation rose faster, even much faster, than was expected” ((1983) 25 BLR 1).

An exception is *Staffordshire Area Health Authority v South Staffordshire Waterworks Co* in which Lord Denning used the rules on construction to terminate an agreement in which the cost of supplying water was approximately 20 times higher than the price agreed on in the contract ([1978] 1 WLR 1387). However, the inflation to which Denning refers is in the span of 16-24 per cent per year (see L Benati, “Long Run Evidence on Money Growth and Inflation” (Bank of England Quarterly Bulletin, Autumn 2005). Denning was also examining a contract entered into more than fifty years before the case was brought to court while the Bulgarian lease was concluded two years before the case was brought to court.

Finally, it is difficult to put oneself in the shoes of a French judge since there is no case law on Article 1195. However, one may argue that a French court would reach a different result from the Bulgarian court. It is unclear whether, from a French perspective, the inflationary change of 6 per cent would be deemed unforeseeable/not assumed as risk by the lessee. It is also uncertain if the French court would establish excessively

onerous performance given the circumstances, including the lessor’s proposal to decrease the rent by 20 per cent.

Historically, French legislators and judges have been troubled by monstrous inflation and/or substantial increase in the price of input goods. When French legislators intervened with temporary statutes in the aftermath of World War I, it was estimated that between 1914-1918 French prices rose by 500 percent (H Oliver, “Economic Consequences of War since 1790: War and Inflation since 1790 in England, France, Germany, and the United States” (1941) 30 *The American Economic Review* 344, 345). Moreover, a temporary statute introduced in the aftermath of World War II (Law of 18 July 1952) permitted an increase of the minimum guaranteed salary only if a 25 per cent rise of the monthly family consumption was observed (M Vasseur, “French Monetary Depreciation and Methods Used to Remedy It” (1955) 30 *Tulane Law Review* 73, 76). Similarly, as mentioned above, in *Gaz de Bordeaux*, the *Conseil d’Etat* was concerned that the price of coal had increased five times since entry.

### Decision 240/2013

This decision by the Supreme Court of Cassation is interesting because it quashed a prior decision by the VAC. In 2010, the VAC was confronted with a case concerning the 10-year lease of a store selling jeans and shoes which faced low revenues and closed down (Decision 192/2010 on com. c. 446/2010 by the Varna Appellate Court). The contract itself contained a termination clause stipulating that

- the lessee does not have the right to terminate the contract unilaterally during the first 36 months unless it pays the rent for all 36 months;
- the lessee may terminate the agreement after 36 months, but only with a 6-month advance notice.

This clause shows that the parties themselves included specific mechanisms for contract termination: the lessee may terminate the agreement after the 36th month, without paying damages, if it notifies the lessor during the 30th month. Furthermore, the lessee tried to renegotiate the contract and the lessor proposed to decrease the monthly rent by 20 per cent. The court, however, examined extrinsic evidence to establish that while the lessee did not accept the proposed 20 per cent decrease in this contract, it accepted a 12 per cent decrease of rent in another contract it renegotiated.

Similarly to Decision 50/2010, discussed above, the judges admitted the existence of a global financial crisis, but held that there was no proven substantial imbalance of the reciprocal obligations due to it. The court said that “economic onerosity may be recognised only if as a result of the changed economic circumstances, there is an objective and substantial decrease in the rent of real property of a similar type to such an extent that what the lessee owes is disproportionate to what it receives from the lessor”. It concluded that lack of economic profitability cannot be equated to economic onerosity.

Essentially, the VAC reached different results in similar circumstances because it applied dissimilar criteria about the evaluation of the imbalance in the reciprocal obligations in the contract. While Decision 50/2010 relied on the comparison between the revenue of the store and the rent, Decision 192/2010 relied on the real estate market as a criterion. It is thus not surprising that the claimants in the second decision demanded cassation by claiming that Decision 192/2010 contradicted Decision 50/2010.

In Decision 240/2013, the Supreme Court of Cassation quashed Decision 192/2010 on com. c. 446/2010 by stating it was “incorrect”. Bulgaria’s Supreme Court of Cassation termed the criteria used by the appellate court to establish whether a contractual imbalance was present “a reference to legally irrelevant facts”. It affirmed the approach of Decision 50/2010 by declaring that the correct method would be to examine the revenue in the concrete store after the change of circumstances and to compare it both with the revenue prior to the supervening event and with the rent. The Supreme Court of Cassation stated that only this approach may give an objective answer to the question whether there is a lack of equivalence of reciprocal obligations. It concluded that in the said case there was a contractual imbalance as “a direct and immediate consequence of the global economic crisis in which consumption was limited to goods of first necessity” and that the decrease of sales of shoes and jeans was unforeseeable and could not be attributed as fault to any of the parties. It declared that the request for termination had to be honoured and terminated the agreement.

The decision by the Supreme Court of Cassation is interesting for several reasons. Firstly, it demonstrates that Decision 50/2010 of the VAC is not accidental, but compliant with the principle in Article 307. Secondly, it seems crucial that the Supreme Court of Cassation did not consider the termination clause mentioned above (it was not even mentioned in the decision) as a factor in its decision. Thirdly, while all criteria of application of economic onerosity are cumulative, the decision implies that the contractual imbalance (lack of equivalence of obligations) is one of the most important, yet the most difficult to apply uniformly. Although the Supreme Court of Cassation has given clear instructions how to evaluate contractual imbalances in leases, lower courts may diverge on the methodology of evaluation in other types of agreements.

In that light, if English courts were confronted with this case, it seems that they would reach a different conclusion from the one reached by the Supreme Court of Cassation. The agreement’s substantive fairness which might be altered by the supervening event would not be of concern. They would examine the agreement to conclude if the risk of inflation was assumed and if the change in circumstances radically altered what parties agreed upon in their contract. Similarly to the case in Decision 50/2010, the agreement was entered into in 2007 and the claim was filed in 2008. As we saw above, there was a 6 per cent increase of inflation between 2007 and 2008, which seems insufficient to apply frustration. Moreover,

as the lease agreements contained detailed clauses allowing early termination against damages, it seems likely that English judges would conclude that early termination would simply be costlier for the promisee who himself had agreed to these terms and was trying to escape from an imprudent bargain by relying on frustration – an approach which contradicts English law’s values of commercial sensibility and freedom of contract.

Finally, it is highly doubtful that a French court would reach the same conclusion as Bulgaria’s Supreme Court of Cassation either. As indicated in our discussion on Decision 50/2010 above, it is questionable whether a 6 per cent inflationary change would be deemed as unforeseeable at the time of contract entry or that performance would be considered excessively onerous. Moreover, as visible from Article 1195, a key factor is the distribution of risk. The fact that this agreement had a special clause providing for early termination under specific conditions could be deemed as a strong indication that the lessee had assumed the inflationary change as risk.

## CONCLUDING REMARKS: HARMONISATION IMPOSSIBLE?

The above discussion is important because it demonstrates that England, France, and Bulgaria have a distinct approach to hardship not only on paper, but also in practice. In addition, these divergences can be explained with the key role, which context plays in doctrinal development and legal practice. These observations can challenge the common assumption that the attitudes of legal systems are converging in light of the influence of globalisation or harmonisation initiatives. It may be the case that such generalisations flourish because East European jurisdictions are traditionally ignored by comparative researchers. The study on unexpected circumstances, which was published by the Trento Common Core Project, which aims at identifying the common core of principles in Europe, discusses the approach of Slovakia, Lithuania, and the Czech Republic only even though, at the time it was published, the European Union already had eleven members from the former communist bloc (see E Hondius and HC Grigoleit (eds), *Unexpected Circumstances in European Contract Law* (CUIP, 2014)).

If, similarly to Niboyet, we paint the modern spectrum of responses to hardship in Europe, Bulgaria and England will surely stand on the two opposite ends. From a historical perspective, it is interesting that the same event (World War I) triggered different responses and set the pattern for long-term divergences. Moreover, as seen above, contemporary case law illustrates how Bulgarian judges are sensitive to relatively minor imbalances in agreements. This is, of course, consistent with the spirit of Bulgaria’s legal culture which became even more committed to social justice and substantive fairness in contract law because of its communist experience. In turn, unlike Bulgaria, England is a market economy that has not faced drastic legal or ideological changes in its recent history. It has stayed committed to its basic common law values of commercial sensibility and freedom of contract.

The dynamic between Bulgaria and France is also thought-provoking. From the perspective of legal families, a “daughter” parted ways with its alleged “mother” and never looked up to it for guidance in private law again. In general, Bulgaria’s legal development not only challenges traditional legal taxonomies, but also serves as evidence that the legal system is highly responsive to social challenges and creates its own compilatory solutions. Bulgaria’s response to changed economic circumstances evolved primarily because of internal tensions and debates on how social issues had to be addressed rather than because of external influences and blind following of “prestigious” models. In that light, even though Bulgaria and France find each other on the same side of the spectrum of responses towards hardship today, the distance between them is significant. It is likely that the two jurisdictions will continue to reach different results in similar circumstances because of doctrinal divergences and different degrees of sensitivity towards substantive unfairness in contract law.

Contrary to what has been observed in some European jurisdictions, Bulgaria has not been influenced by harmonising instruments like the PECL, the DCFR, etc. There is a timing issue, which cannot be underestimated – Bulgaria carried out its major reforms in civil and commercial law in the early 1990s when these instruments were not developed. Above all, however, Bulgaria’s legal cultural particularities persist. In my prior work, I have shown that even the detailed commentaries in the DCFR are insufficient to harmonise the responses of Bulgaria with other jurisdictions because Bulgaria’s idiosyncrasies were not taken into consideration when drafting the DCFR and the accompanying commentaries (see “Lessons for the Harmonization of Contract Law in the European

Union” in R Vassileva, *Change of Economic Circumstances in Bulgarian and English Law. What Lessons for the Harmonization of Contract Law in the European Union?* (Doctoral Thesis, University College London, 2016) at ch 6). It should not be surprising that Bulgarian judges do not reason like English or French judges – the current senior judges earned their degrees during communism and survived crucial social and ideological changes, which have influenced their way of thinking and their values.

Ultimately, harmonisation between England, France, and Bulgaria, at least on the question of hardship in commercial contracts, seems impossible at this stage. The question, which remains, is how troublesome this is. From a legal cultural perspective, diversity is embraced. In practice, however, Western companies which contract with Bulgarian companies usually impose their national law as governing the agreement because they fear Bulgaria’s interventionist approach. Bulgarian companies often cannot afford the legal fees of foreign lawyers, so they sign agreements without proper advice. If something goes wrong, they do not have the resources to defend their interests either. In other words, legal cultural diversity comes with a hefty price tag for Bulgarian businesses.

#### **Dr Radosveta Vassileva**

*PhD in Law (University College London); Master en droit (Sciences Po Paris); Master en droit (Université de Paris I Panthéon-Sorbonne); Teaching Fellow at University College London.*

# Combating the laundering of proceeds of crime in the United Kingdom: an analysis of the Criminal Finances Act 2017

by Sirajo Yakubu

## INTRODUCTION

The Criminal Finances Act (CFA) 2017 is the most important piece of anti-money laundering (AML) legislation that the United Kingdom has ever had. The 2017 Act seeks to tackle money laundering and unexplained wealth; tax evasion; corruption; and the financing of terrorism. Also, CFA 2017 strengthens the law relating to the recovery of the proceeds of crime. One of the most significant innovation the CFA 2017 brought into the UK's AML landscape is the codification of unexplained wealth orders (UWOs) into the Proceeds of Crime Act (POCA) 2002. POCA 2002 is the main AML legislation in the UK.

The main issues this article analyses are the amendments the CFA 2017 made to the POCA 2002. However, this article does not attempt to discuss all the amendments CFA 2017 had made to POCA 2002, and thus limits its analysis in the following areas: suspicious activity reports, sharing of information among bodies in the regulated sector, and the newly introduced law on UWOs.

This article is divided into four parts. Part I analyses the amendment CFA 2017 made to POCA 2002 provisions on suspicious activity reporting (SAR). CFA 2017 reforms the way SAR is being handled; law enforcement can now apply to the court for the extension of the 31 days moratorium period for up to six times consecutively. Part II discusses the new provision that allows regulated entities to share a suspicion of money laundering with one another. This provision is significant in many respects. For example, sharing of information on suspicion of money laundering among the regulated persons will help in exposing and preventing money laundering, and will also help in tracing the money. Part III analyses the newly introduced UWOs, seen as a noble approach to combating the laundering of the proceeds of crime into or in the UK. Finally, Part IV draws an analogy from the offences of corporate failure to prevent corruption and corporate failure to prevent

the facilitation of tax evasion, and suggests that an “offence of corporate failure to prevent money laundering” should be enacted.

## PART I: THE SUSPICIOUS ACTIVITY REPORT

CFA 2017 changed the way SAR is handled. CFA 2017, section 10 amended Part 7 of POCA 2002 to allow for the 31-day moratorium period to be extended successively up to six times (186 days in total) beginning from the day after the end of the initial 31 days. During the moratorium period, the reporting person is prohibited from dealing with the asset. Thus, the asset is effectively frozen albeit temporarily. The essence is to allow investigators more time to collect evidence for further action such as applying to the court for a restraining order. Before this amendment, the moratorium period could not be extended beyond 31 days. This period, as provided by the old law, does not give enough time for law enforcement to conduct a proper investigation, especially where evidence is located abroad.

However, for the moratorium period to be extended an application must be made to the relevant court before the end of an existing moratorium period. The relevant court in England and Wales is the Crown Court, while in Scotland is the Sheriff (Criminal Finances Act 2017 Circular 008/2018). The court may only grant an extension where it is satisfied that: an investigation is being conducted diligently and expeditiously, further time is required, and the extension is reasonable (CFA 2017, s10 inserts s 336A into POCA 2002).

It is interesting to note that, following complaints from the banks, the government promised to reform the consent regime to allow the reporting person to carry on with a suspicious transaction after filing an SAR if discontinuing the transaction would alert the client to an impending investigation (Home Office and HM Treasury, UK Action Plan on Anti-Money Laundering and Counter-Terrorist Financing 2016 (Action

Plan 2016) Annex B). However, to the contrary, the law extends the moratorium period by six months during which the reporting person is prohibited from dealing with the asset.

During the debate, the minister for security, Ben Wallace, explained that 31 days was not enough to conduct money laundering investigation properly to the end, especially where evidence was located abroad or where the case involved grand foreign corruption or other serious crime (HC Debates, 17 November 2016, vol 617, cols 98-99). The minister also explained that extending the moratorium period would protect the proceeds of crime from being dissipated when there was a suspicion that ML activity had taken place, and when the law enforcement agency had not had the opportunity to complete its inquiries.

The Home Office has issued a circular (Criminal Finances Act 2017, circular 008/2018) to serve as a guide to the law enforcement agencies and reporting agencies on how to handle the application, information-sharing relating to the application for extension of moratorium period, and the role of courts in determining the application. Where law enforcement agencies or investigating agencies consider an extension of the moratorium period, the agency must liaise with the United Kingdom Financial Intelligence Unit (UKFIU). UKFIU is the national repository for all authorised disclosures and is also responsible for decisions concerning the granting or refusal of defence against money laundering (DAML). As soon as an applicant (any of the designated law enforcement agencies) decides to seek an extension of the moratorium period, the applicant must immediately engage with the UKFIU which is domiciled at the National Crime Agency (NCA). The rationale is to help the UKFIU in its decision-making process regarding the matter, and allow the UKFIU to raise with the law enforcement agency any concerns it may have about the application for extension.

While extending the moratorium period will allow ample time to law enforcement to conduct a proper investigation, regard must be had to the tipping off offence (Proceeds of Crime Act 2002, ss 333A – 333E). A tipping off offence occurs where a person (typically a bank employee) knows or suspects that a disclosure falling within section 337 or 338 of POCA 2002 has been made, and he/she informs the affected client of the disclosure, which action is likely to prejudice any investigation which might be conducted following the disclosure. Even under the old consent regime, where a bank could not conclude a client's transaction due to a disclosure which had been made, the affected client was likely to contact their bank to find out why the transaction was delayed (*Shah v HSBC* [2010] EWCA Civ 31). The law requires the bank to decline to inform the client that the transaction has been reported, otherwise a tipping up offence is committed.

However, the person who made the disclosure may find it difficult to keep the client uninformed throughout the moratorium period in order to avoid tipping off (*Bank of Scotland v A Ltd* [2001] 1 WLR 751; *C v S* [1999] 1 WLR 1551; and *Shah v HSBC* [2010] EWCA Civ 31) especially now that

the period can be extended by up to 186 days. On the other hand, keeping clients uninformed would also indirectly tip them off, as it is likely that they would suspect that they were under investigation because of the common knowledge that ordinarily a bank would explain to them the events leading to the delay if the events were such that either the bank or the client could resolve the issue. To address this, the tipping off offence under section 333A of POCA is disapplied when an application to extend is made (Criminal Finances Act 2017, circular 008/2018). CFA 2017 inserted a new provision after section 333D(1) of the Proceeds of Crime Act 2002, and the new section 333D(1A) states:

*Where an application is made to extend a moratorium period under section 336A, a person does not commit an offence under section 333A if:*

- (a) the disclosure is made to a customer or client of the person,*
- (b) the customer or client appears to the person making the disclosure to have an interest in the relevant property, and (c) the disclosure contains only such information as is necessary for the purposes of notifying the customer or client that the application under section 336A has been made.*

## PART II: VOLUNTARY SHARING OF INFORMATION

Another important feature in the Criminal Finance Act (CFA) 2017 is the new provision that allows voluntary sharing of information between bodies in the regulated sector and between those bodies and the police or the NCS in connection with suspicions of money laundering (CFA 2017, s 11 inserts ss 339ZB-339ZG into POCA 2002). Also, TACT 2000 is amended in a similar way for countering terrorism and terrorist financing (CFA 2017, s 36 inserts s 21CA-21CF into TACT 2002). It should be noted that under this provision sharing of information is entirely voluntary (circular 007/2018, Criminal Finances Act 2017 – Sharing of Information within the Regulated Sector). Also, this provision is different from the legal obligation to file SARs. While sharing information under this provision is entirely voluntary, filing SARs is mandatory. It should also be noted that sharing of information can be instigated by the NCA (CFA section 339ZB(3)).

Part 2 of CFA 2017 brings the fight against terrorist financing in line with the fight against money laundering, reflecting existing provisions relating to a financial crime (HC Debates, November 2016, vol 617 cols 122-23). It does so by making the tools available for terrorist finance investigations and the powers available to seize terrorist cash and property as comprehensive as those available for dealing with other financial crime or, in some cases, even more robust (HL Deb October 2016 volume 616, columns 198-99).

The CFA 2017 also expands the investigative power of the law enforcement such as the Serious Fraud Office in relation to money laundering. The Act extends the disclosure order in confiscation proceedings involving cases, such as money laundering and fraud (Criminal Finances Act 2017, s 7).

Disclosure orders empower law enforcement to require anyone that they believe has relevant information to an investigation, to answer questions, provide information or to produce documents (Edmund Smyth and Jonathan Blunden, “Criminal Finances Act 2017” (Kingsley Napley) 2 May 2017).

Money laundering is usually detected at the placement stage. Where transactions in criminal assets evade detection at the placement stage the reporting entities would neither have any suspicious activity to report nor would they engage in voluntary sharing of information. Consequently, a money laundering scheme would progress to the layering stage and finally through the integration stage. Thus, allowing for voluntary sharing of information between bodies in the regulated sector and between those bodies and the police or the National Crime Agency in connection with suspicions of money laundering is a right step in the right direction. This provision is significant in many respects. For example, sharing of information on suspicion of money laundering among the regulated persons will help in exposing and preventing money laundering, and will also help in tracing where the money goes to if the laundering scheme has been completed. However, whether this provision would be an effective tool against money laundering would depend on some factors.

One of such factors is the willingness of the regulated persons to share the suspicion of money laundering. Where employees of the regulated person are part of the money laundering scheme, a SAR will not be filed and therefore obviously the question of voluntary sharing of information may not even arise. There are many instances where top management of banks facilitated the laundering of proceeds of crime for highly placed individuals. For example, in the United States, the case of Lucy Edwards – a very senior official of the Bank of New York – reveals the extent employees can go to in undermining the effectiveness of AML laws to their own personal gain (*US v Peter Berlin and Others* 99 Cr. 914 (SWK)). In the UK, HSBC, RBS, Lloyds and Barclays are among the 17 banks suspected of laundering about US\$ 740 million belonging to a Russian oligarch (*The Guardian*, 20 March 2017). The banks were accused of failing to turn away suspicious money transfers.

There may also be the fear of betrayal among the bodies in the regulated sector. Thus, bank A may not share information with bank B if bank A fears that due to competition bank B is likely to secretly reveal to the client that it has received such information from his/her bankers – bank A. In extreme cases, a bank will decline to share such information with any bank if it fears that its client would directly or indirectly get to know about it. For example, where bank A passes information to B, it is likely that bank B would pass such information to bank C, and C pass it to D, E and F. Even if the client of bank A did not get that information directly from bank B, getting that information from C or D or E cannot be ruled out. Thus, to avoid reputational damage, a regulated person may decline to pass information about its client’s suspicious transactions.

When a criminal asset is finally integrated into the economy, a piece of unexplained wealth resurfaces. Although

the provenance of the resurfaced wealth may be suspicious, law enforcement agencies would not be able to confiscate the laundered criminal assets due to lack of evidence. Money laundering is the lifeblood of crime and criminals, and the availability of money to criminals makes money laundering flourish because with money criminals can easily hire the best services of professional launderers and bribe their way through the financial sector and gatekeepers. To augment the money laundering provisions as well as the civil recovery process, CFA 2017 introduced into POCA 2002 unexplained wealth orders regime, which targets resurfaced laundered criminal assets.

### PART III: UNEXPLAINED WEALTH ORDERS

Among its range of powers, Part 1 of the CFA 2017 introduced for the first time in the UK the power to compel a suspect to explain the source of his/her wealth. The UWO is an investigatory power given to law enforcement to compel persons suspected of criminal activity to explain the provenance of the wealth they have acquired overnight and which is disproportionate to their known income. Failure to respond to the order triggers the presumption that the property represents the proceeds of crime.

Under POCA 2002, law enforcement officers are unable to confiscate the proceeds of crime due to the difficulty in obtaining evidence, especially where the evidence is located abroad. CFA 2017 (s 1) inserts into POCA 2002, section 362A-362I to aid the recovery process under POCA 2002. During the House of Commons debate on the Criminal Finances bill, the minister for security, Mr Wallace, stated that:

*Unexplained wealth orders will flush out evidence to enable enforcement agencies to take forward recovery action under POCA. Such an order will require a person to provide information that shows that they obtained identified property legitimately. If they do so, agencies can then decide whether to investigate further, take civil recovery action or take no further action. If the person does not comply with the order, the property identified in the order is presumed to be recoverable under any subsequent civil recovery proceedings (HC Debates, 17 November 2016, vol 617, col 87).*

Section 1 is aimed at tackling foreign Kleptocrats, and corruption and other crimes inside the UK (CFA 2017, s 1). Although this article does not discuss corruption in greater detail due to lack of space, it is worth mentioning that corruption is a real issue in the UK for several reasons. First, it is the failure to have an anti-corruption law (to tackle corrupt practices) that led the Financial Action Task Force (FATF) and the Organisation for Economic Corporation and Development (OECD) to be critical of the UK’s commitment to prevent corruption (F Joseph Warin and others, “The British are coming: Britain changes its law on foreign bribery and joins the international fight against corruption” [2010] 46(1) *Texas International Law Journal* 1, 4-5).

Second, corruption is a stumbling block in enforcing AML law because evidence tends to suggest that organised

crime groups corrupt and penetrate institutions (European Commission Report, “Examining the links between organised crime and corruption” (2010); NCA, “Strategic assessment of serious and organised crime”, (2014) pp 7, 10, 13, 20; Fletcher N Baldwin and Theresa A DiPerna, “The rule of law: an essential component of the financial war against organized crime and terrorism in the Americas” [2007] 14(4) *Journal of Financial Crime* 405-37). While there is a nexus between corruption and terrorist financing, there is a symbiotic relationship between corruption and money laundering (David Chaikin and Jason C Sharman, *Corruption and Money Laundering: A Symbiotic Relationship* (Springer, 2009)).

Following the BAE-Al Yamamah defence contract scandal and the resultant international pressure, especially from outside the UK, the government presented a bill, which culminated in the enactment of the Bribery Act 2010. Section 7 created an offence of corporate failure to prevent corruption. Under section 7(1), a relevant commercial organisation is guilty of an offence if a person associated with it bribes another person intending to obtain or retain business for the commercial organisation or to obtain or retain an advantage in the conduct of business for the commercial organisation. Thus, to avoid criminal liability a company must establish and maintain adequate measures to prevent its officers and agents from breaching section 7(1). In 2016 the SFO secured a conviction against a UK company, Sweett Group Plc, for failure to prevent corruption offence (*Serious Fraud Office v Sweett Group Plc*, unreported, 19 February 2016 (Southwark Crown Court)).

Section 7 of the Bribery Act 2010 is aimed at preventing corruption. However, what has happened to the proceeds obtained in breach of section 7, or stolen assets associated with foreign PEPs, or the proceeds of drug trafficking? Since corruption and other crimes cannot be eradicated completely, another mechanism is needed to attack the criminal proceeds whenever they resurfaced. In *Serious Fraud Office v Sweett Group Plc*, although Sweett was ordered to pay £2.35 million, this amount is not the actual bribe paid. The bribe money remained in the hands of the persons to whom it was paid. If the person to whom the bribe was paid, laundered the money into the UK, for example, by buying a property, and there is no sufficient evidence to link the person to the bribe money, the law enforcement may find it difficult to recover that money. A research conducted by Transparency International identified a total of £4.2 billion properties in London bought by individuals with suspected wealth (“Unexplained wealth orders: how to catch the corrupt and corrupted in the UK” (Transparency International, 28 April 2017)). Thus, UWOs provide a mechanism to investigate the source of assets suspected of being proceeds of crime, especially because illicit proceeds are normally laundered before finally resurfacing as clean assets.

The first UWOs the National Crime Agency has secured in the UK were against two separate properties (one in London and the other in South East England worth over £22 million) belonging to a yet unnamed politically exposed person (PEP) (National Crime Agency, News, 28 February 2018). Once the

court grants a UWO, an interim freezing order (IFO) needs to be obtained to protect the asset subject of the order, otherwise the asset could be sold, transferred or dissipated. Commenting on the first UWOs secured, Donald Toon, Director for Economic Crime at the NCA, said:

*Unexplained wealth orders have the potential to significantly reduce the appeal of the UK as a destination for illicit income. They enable the UK to more effectively target the problem of money laundering through prime real estate in London and elsewhere. We are determined to use all of the powers available to us to combat the flow of illicit monies into, or through, the UK (National Crime Agency, News, 28 February 2018).*

In addition to UWOs, Chapter 3 of the CFA strengthens the POCA civil recovery regime, giving new powers to law enforcement to tackle money laundering, terrorist financing and organised crime through asset forfeiture. First, gaming vouchers, fixed-value casino tokens, and betting receipts are now included in the list of items that are regarded as cash (CFA 2017, s 14 inserts these provisions into POCA 2002, s 289). This is because they store value and can easily be transferred, which make them attractive to money launderers. Second, law enforcement authorities are now empowered to forfeit certain personal (or moveable) properties (CFA 2017, s 15 inserts s 303B – 303Z into POCA 2002), and money held in bank and building society accounts worth £1,000 and above – there is no upper limit (CFA 2017, s 16 inserts s 303Z1 – 303Z19 into POCA 2002).

Most importantly, the law ushered in administrative forfeiture into the UK anti-money laundering regime, albeit it being applicable only to money in the account of a bank or building society (HC Debates, 17 November 2016, vol 617, col 110). However, despite the decision of the court in *Merida Oil Traders Ltd, R (On the Application of) v Central Criminal Court* [2017] EWHC 747 (Admin), that possession of a substantial quantity of cash inherently gives rise to suspicion, making the processes of forfeiting such cash easier and less rigorous, potential difficulties remain especially regarding the forfeiture of money held in a bank account (Jasvinder Nakhwal and Nicholas Querée, “The Criminal Finances Act 2017: Account Freezing and Forfeiture Provisions”, (2017) 181 *Criminal Law & Justice Weekly* 303, 304).

Although unexplained wealth orders would enhance AML law by aiding civil recovery process, the regime appears to be less successful than its promoters thought it will be. To date, there were only two UWOs and one arrest made as a fall out of an unsatisfactory response to unexplained wealth order (Irene Madongo, “Money Laundering: UK Arrests Former PEP with £8 million property portfolio”, KYC 360, 21 September 2018)). As the targets of the UWOs are mainly foreign PEPs, the question is whether the UK PEPs are immune from corruption or at least less corrupt than foreign PEPs (Emma Smith, “Culture of impunity’ among MPs over hospitality from corrupt regimes: Transparency International UK finds that thousands was spent for MPs to visit Azerbaijan”, *The Guardian*, 30 July 2018).



In applying for a UWO, having a background knowledge of a PEP and the prevailing situation in the PEP's country is important. It would not be enough for law enforcement to apply for a UWO against PEPs just because they are or were foreign PEPs and they individually own a property worth £50,000 or more, otherwise applying for a UWO would amount to waste of time and tax payer's money. CFA 2017, section 1 inserts section 362B into the Proceeds of Crime Act 2002, which specifies the requirements for making an application for a UWO.

One of the requirements is that there must be a reasonable ground for suspecting that the known sources of the respondent's lawfully obtained income would have been insufficient for the purposes of enabling the respondent to obtain the property. Whether a suspicion may arise as to the provenance of the funds with which a foreign PEP acquired a property will depend on many factors, which include but are not limited to the following: whether the investigator knows how much a PEP earns in his country; the access a PEP has to a loan facility; whether the investigator knows what type of businesses PEPs are by the law of their own countries allowed to engage in; and the time at which the property was acquired.

Knowledge of how much a PEP earns in his country is critical to any investigation preceding a UWO application. For example, Nigerian senators receive about 13 million naira (equivalent to £27,500) per month as monthly expenses in addition to a salary of about £2,000, (*Premium Times* (Abuja) 7 March 2018). Thus, it is within a Nigerian senator's lawful means to own a property worth £50,000. The £27,500 monthly expenses alone translate to £1.32 million in a tenure of four years, and these earnings do not include the severance package they receive when leaving office after four years. As the cost of living in Nigeria is cheap, politicians can make savings from their lawful earnings even if they completely shun corruption. Despite this, however, suspicion may arise where a PEP acquires a property in the UK worth £500,000 or more because it is expected that a PEP has other responsibilities which obviously require money to discharge. Furthermore, because of the ingrained fraud and corruption factors in Nigeria, properties bought by a Nigerian PEP in the UK and other countries are likely raise suspicion. Therefore, lack of a good knowledge of countries of foreign PEPs will be an obstacle to a successful UWO.

There are many other obstacles to a successful UWO. A major one is that explanation can be made to justify the sources of the resurfaced wealth. Where a lawyer in the country where the suspected assets emanate provides evidence that the subject of the order got the money with which he acquired the properties for example from an oil block, copper mine or rubber plantation belonging to his family, the UWO is likely to be defeated. It is worthy to note that in countries that are notorious for corruption such as Nigeria, public servants including politicians are allowed to engage in agricultural business while serving in office. Thus, in response to UWO, it is easy for Nigerian PEPs to provide a clear evidence that they

obtained the property through their legal means even if the property is bought with stolen money.

Evidence of inheritance can also serve as a defence to a UWO. For example, in Nigeria the Wills Act 1837 and the wills laws of the various States of Federation allow a testator to dispose of his property freely. Thus, if a PEP can show that someone bequeathed properties to him in a will, a UWO can easily be defeated. Other obstacles to a successful unexplained wealth orders include human rights issues that may arise from making the order.

On the part of the respondents, UWOs could be detrimental to business. A UWO against a respondent may lead to bad publicity and loss of opportunity and profit even where the money is at the end found to be clean. This problem can be better explained by reference to *Shah v HSBC* [2010] EWCA Civ 31. In *Shah*, following a SAR his bankers, HSBC UK Ltd filed to a law enforcement agency (probably the Serious Organised Crime Agency) rumours spread in Zimbabwe that the first claimant was suspected of money laundering, which allegedly caused the Zimbabwean authorities to freeze and then seize his assets, causing him losses of over US\$300m. However, the court failed to order compensation to be paid to *Shah* on the basis that the banks did not breach any duty. While *Shah* sued HSBC for breach of contract or duty of care, as regards to UWOs the respondent may not sue the regulated person that made the report but the law enforcement that applied for the UWO. Whether the courts will order the relevant law enforcement agency to pay compensation to the respondent remains to be seen.

#### PART IV: CONCLUSION – THE NEED FOR A CORPORATE OFFENCE OF FAILURE TO PREVENT MONEY LAUNDERING

While corporate entities are the building blocks of economic development, criminals use some of them as vehicles for money laundering. In view of this, creating a new offence of failure to prevent money laundering is necessary to protect corporate entities from abuse and the economy from pollution. Similar offences of failure to prevent exist in the UK statute books – corporate failure to prevent corruption and corporate failure to prevent the facilitation of tax evasion.

CFA 2017, Part 3 created the offence of corporate failure to prevent the criminal facilitation of tax evasion. During the debate on the Criminal Finances Bill in the House of Lords, the Minister for Security explained:

*It [the Bill] also goes some way to dealing with people who evade tax overseas. Just because they are not evading our tax but are robbing another country, it does not mean that we would not still like to take action against those individuals* (HL Debates, October 2016, vol 616, col 194).

A corporate body will be vicariously liable for failure to prevent the criminal facilitation of the UK and foreign tax evasion where that body has not put in place necessary

measures to prevent its employees or agents from facilitating tax evasion (CFA 2017, ss 45 and 46). Criminal facilitation is defined by the Accessories and Abettors Act 1861, section 8. This section has been examined in *Jogee and Ruddock v The Queen (Jamaica)* [2016] UKSC 8.

However, these offences are not offences of corporate failure to prevent itself from evading tax and do not create a legal obligation for corporations to prevent their client's tax evasion (HC Debates, November 2016, vol 617, cols 136). Having reasonable prevention procedures in place serves as a defence to a charge of failure to facilitate (CFA, ss 45(2) and 46(3)).

This offence mirrors section 7 of the Bribery Act 2010, which criminalised the failure of corporate bodies to prevent corruption. Like section 7, it appears that Parliament intended section 45 to have extraterritorial effect, to allow law enforcement to go after those who encourage people to evade UK tax wherever they are domiciled in the world (HC Debates, November 2016, vol 617, col 139).

However, the new tax offences have gone one step further. Unlike a section 7 offence, sections 45 and 46 offences are not premised on the associated person himself evading tax. (Anita Clifford, "Failure to prevent: corporate liability at the cost of individual due process?" (Bright Line Law) 6 June 2017). Nevertheless, this could lead to due process deficit because in its present form, the tax model appears to permit a court finding that an individual has committed a tax evasion facilitation offence, even if he has never had the opportunity

to defend himself against the accusation of criminal conduct (see Anita Clifford, above). While this could help in fighting tax evasion, it remains to be seen whether HM Revenue and Customs will optimally utilise the new powers, as powers previously given were under-utilised (HL Debates, October 2016, vol 616, cols 209-10).

The Act, however, fell short of creating the offence of corporate failure to prevent money laundering. The designers of the CFA 2017 are very ambitious, as the Act expands the powers of the law enforcement in relation to combating financial crimes and terrorist financing. Whether the Act will in practice operate optimally to achieve the purpose it was designed for remains to be seen (see Nicola Padfield, "The Criminal Finances Act" [2017] *Criminal Law Review* 505).

As CFA 2017 failed to create the offence of "corporate failure to prevent money laundering", it is submitted that relevant UK authorities should monitor the performance of the two models of failure to prevent offences – failure to prevent corruption and failure to prevent the facilitation of tax evasion – with a view to considering enacting the offence of "corporate failure to prevent money laundering". Creating the offence of failure to prevent money laundering coupled with the requirement of corporate transparency (see Sirajo Yakubu, "Flaky AML? Saving the 'World Class' UK Public Register from Shambles, KYC 360, 21 May 2018) would strengthen the fight against money laundering in the UK.

**Dr Sirajo Yakubu Esq**

*Researcher and Consultant in Economic Crime*

## CONSULTANT EDITORS

### Administrative Law

**Prof Christopher Forsyth** Faculty of Law, University of Cambridge  
**Sir Derek Oulton** Life Fellow Magdalen College, Cambridge  
**Prof Alan C Page** Professor of Public Law, University of Dundee

### Arbitration

**Julian Critchlow** Fenwick Elliot  
**Samuel Haubold** Littleton Chambers  
**Prof A F M Maniruzzaman** Professor of International and Business Law and Director of Postgraduate Studies and Research in Law, School of Law, University of Portsmouth  
**Dr Colin Ong** Essex Court Chambers

### Banking Law and Practice

**Prof Andrew Campbell** Professor of International Banking and Finance Law, University of Leeds  
**Prof Richard Hooley** Professor of Law, King's College London  
**Peter Richards-Carpenter** Fried Frank LLP

### Civil Litigation and Procedure

**Saul M Froomkin QC**, Mello Jones & Martin, Bermuda  
**Phillip Howell-Richardson** Independent Mediator  
**Jon Lang** Independent Mediator  
**Dick Pears** Tanfield Chambers

### Commercial Law

**Prof Michael Bridge** Cassel Professor of Commercial Law, LSE  
**Prof Stephen Weatherill** Jacques Delors Professor of European Law, Oxford

### Company Law

**Prof Anthony Boyle** Emeritus Professor of Law, Queen Mary, University of London  
**Tim Frazer** Arnold and Porter LLP  
**Prof Joanna Grey** Professor of Financial Regulation, University of Newcastle  
**Dr John McMullen** Wrigleys Solicitors LLP, Visiting Professor of Law, Durham University  
**Chris Riley** Reader, Director of the Institute for Commercial and Corporate Law, University of Durham  
**Jerry Walter** Fried Frank LLP  
**Prof Adrian Walters** Professor of Corporate and Insolvency Law, Nottingham Trent University

### Competition Law

**Tim Frazer** Arnold and Porter LLP  
**Professor Richard Whish** Professor of Law, King's College London

### Computers and the Law

**Prof Ross Anderson** Professor of Security Engineering, University of Cambridge  
**Dr James Backhouse** Reader, Information Systems and Innovation Group, LSE  
**Prof Michael Froomkin** School of Law, University of Miami

### Constitutional Law

**Prof Robert Blackburn** Professor of Constitutional Law, King's College London  
**Prof Robert Hazell** Professor of British Politics and Government, Director of the Constitution Unit, UCL  
**Professor Colin Munro** Emeritus Professor of Constitutional Law, University of Edinburgh

### Contract

**Dr Mahmood Bagheri** IALS  
**Professor Andrew Tettenborn** University of Swansea

### Corporate Finance

**Simon Gleeson** Clifford Chance  
**Christopher Hale** Travers Smith  
**Prof Andrew Haynes** University of Wolverhampton  
**Ned Swan** Visiting Professor, UCL

### Criminal Law

**Prof Estella Baker** Professor of European Criminal Law and Justice, De Montfort University  
**Sheilagh Davies QC** 9 Lincoln's Inn Fields  
**Prof David McClean CBE**, QC Emeritus Professor, University of Sheffield  
**The Hon Mr Justice Silber**  
**Prof Anthony Smith** Dean, Faculty of Law and Pro Vice Chancellor (Government Relations) Victoria University of

Wellington, New Zealand

### Employment Law

**Viv Du-Feu** Capital Law LLP  
**Jennifer Eadey QC** Old Square Chambers  
**Dr John McMullen** Short Richardson & Forth LLP, Visiting Professor of Law, Durham University

### Environmental Law

**Richard Burnett-Hall** Consultant, Bristows  
**David Ong** Reader, University of Essex

### European Law

**Prof Estella Baker** Professor of European Criminal Law and Justice, De Montfort University  
**Prof Christopher Bovis** H K Bevan Chair, University of Hull  
**Frédérique Dahan** Senior Counsel, European Bank for Reconstruction and Development  
**Prof Jo Shaw** School of Law, University of Edinburgh  
**Prof Stephen Weatherill** Jacques Delors Professor of European Law, Oxford

### Family

**Graham Ritchie** solicitor

### Financial Crime

**Rowan Bosworth-Davies** Financial Crime Consultant  
**Prof Louis de Koker** School of Law, Faculty of Business and Law, Deakin University, Australia  
**Dr Chizu Nakajima** Director, Centre for Financial Regulation and Crime, Cass Business School, City University  
**Richard Purlour** Financial Markets Law International  
**Prof Barry A K Rider** Professorial Fellow, Development Studies Programme, University of Cambridge, Fellow Commoner and sometime Fellow, Dean and Tutor of Jesus College, Cambridge, former Director, IALS

### Financial Markets

**Prof Eva Lomnicka** King's College London  
**Prof Barry A K Rider** Professorial Fellow, Development Studies Programme, University of Cambridge, Fellow Commoner and sometime Fellow, Dean and Tutor of Jesus College, Cambridge, former Director, IALS

### Financial Services

**Dr Richard Alexander** Lecturer in Financial Law, SOAS  
**Prof Joanna Benjamin** Emeritus Professor of Law, LSE  
**Martyn J Bridges** Bridges & Partners  
**Prof Alastair Hudson** Professor of Equity and Law, Queen Mary, University of London  
**Dr Oonagh McDonald** CBE  
**Dr Chizu Nakajima** Director, Centre for Financial Regulation and Crime, Cass Business School, City University  
**Prof Barry A K Rider** Professorial Fellow, Development Studies Programme, University of Cambridge, Fellow Commoner and sometime Fellow, Dean and Tutor of Jesus College, Cambridge, former Director, IALS  
**Margarita Sweeney-Baird** Part-time Honorary Visiting Lecturer, Department of Accounting and Finance, University of Birmingham

### Human Rights

**Prof Mads Andenas** Professor of Law at the universities of Leicester and Oslo  
**Sir Geoffrey Bindman QC** Bindmans LLP  
**Rt Hon Mr Justice Blake**  
**Prof Steven Greer** Professor of Human Rights, University of Bristol  
**Khawar Qureshi QC** Serle Court, Visiting Professor in Commercial Law, SOAS  
**Geoffrey Robertson QC** Doughty Street Chambers

### Insolvency

**Prof David Milman** Professor of Law, University of Lancaster  
**Prof Dan Prentice** Erskine Chambers, Emeritus Professor of Corporate Law, University of Oxford  
**Prof Adrian Walters** Professor of Corporate and Insolvency Law, Nottingham Trent University

### Intellectual Property

**Paul Garland** Kemp Little LLP  
**Paul Harris** Speechly Bircham

### International Financial Law

**Prof Mads Andenas** Professor of Law at the universities of Leicester and Oslo  
**Prof Ravi Tennekoon** King's College London

### International Trade Law

**Prof Kern Alexander** Professor of Banking and Financial

Market Law, University of Zurich, Senior Research Fellow, IALS

**Prof Joseph McMahon** Professor of International and Business Law and Director of Postgraduate Studies and Research in Law, School of Law, University of Portsmouth

### Jurisprudence

**Prof William Twining** Emeritus Quain Professor of Jurisprudence, UCL

### Legal Education and Practice

**Prof Kim Economides** University of Otago, New Zealand  
**Prof Richard Moorhead** Professor of Law, UCL  
**Prof Avrom Sherr** Woolf Professor of Legal Education and Director on Sabbatical, Institute of Advanced Legal Studies  
**Richard Susskind OBE** Visiting Professor in Internet Studies, Oxford Internet Institute, University of Oxford

### Maritime & Shipping Law

**Richard Siberry QC** Essex Court Chambers

### Planning Law

**Richard Harwood** 39 Essex Street Chambers

### Public International Law

**Prof Christine Chinkin** Professor of International Law, LSE  
**Prof A F M Maniruzzaman** Professor of International and Business Law and Director of Postgraduate Studies and Research in Law, School of Law, University of Portsmouth

### Religion and Law

**Prof Dr John Warwick Montgomery** Professor Emeritus of Law and Humanities, University of Bedfordshire, Distinguished Research Professor, Concordia University Wisconsin (USA)

### Restitution and Contract Law

**Prof Gerard McCormack** Professor of International Business Law, University of Leeds  
**Professor Andrew Tettenborn** University of Swansea

### Trade Union Law

**Jennifer Eadey QC** Old Square Chambers  
**John Hendy QC** Old Square Chambers

### Trusts and Equity

**Hon Mr Justice David Hayton** Caribbean Court of Justice  
**Professor Paul Matthews** King's College London  
**Prof Sarah Worthington** Faculty of Law, University of Cambridge

